

NEWS: EUROPE

Lionel Barber tells the story - and the moral - of a weekend of secret European diplomacy

The quest for Emu: Italy home but not dry



Preparing for Emu

As if they were going badly wrong. Twelve hours of negotiations in Brussels stretching over two days had produced a stalemate.

The Italian terms were remarkably close to the parity of 1980 to 1990 sought by the bulk of Italy's EU partners, but a majority of EU central bank governors were opposed.

With the financial markets in the Far East due to open at midnight, one or two faint spirits began to wonder if there was a chance that the informal deadline for an agreement might slip, leaving the lira floating in a sea of political discontent.

Several dozen finance ministers, central bankers and treasury officials took part in the weekend bargaining in Brussels, but in the end it came down to a battle of wills between two men: Mr

Tietmeyer, the towering apostle of price stability and monetary orthodoxy, and Mr Carlo Azeglio Ciampi, the diminutive 76-year-old Italian treasury minister whose craftiness is legendary.

Like Mr Tietmeyer, Mr Ciampi had a far bigger agenda. Both saw the conduct and outcome of the negotiations as a prelude to the debate on whether Italy can realistically hope to join the first group of EU countries launching economic and monetary union in 1999.

For Mr Ciampi, a favourable response to Italy's demands would signal political support for a "broad" monetary union going beyond the "core" grouping built around France and Germany. Entering the ERM two years ahead of the planned launch of the single currency would enable Italy to meet one of the Maastricht criteria.

For Mr Tietmeyer, it was vital to show that no member state government could expect to dictate the terms of entry into the ERM. Memoranda were still fresh of how the British government unilaterally set a rate of DM2.95 to the pound in 1990, only to crash out two years later.

The consensus among EU diplomats and monetary officials yesterday was that the re-entry level of 1990 to the D-Mark looks like a coup for Italy's centre-left government led by Mr Romano Prodi. A closer look confirms this view.

Timing is everything in the currency markets. Mr Prodi and his colleagues debated for several weeks when it would be best to re-enter the ERM. Pressure accelerated once the chamber of deputies approved the 1997 budget which aims to bring the public deficit to close to 3 per cent of gross domestic product, the target set by the Maastricht treaty.

The Prodi government's decision to call for a weekend meeting of the EU's monetary committee - a secretive panel of national treasury officials and central



Ciampi: a dream fulfilled

bankers - was taken after the close of markets in Europe on Friday. But several officials say the subsequent failure to reach agreement during nearly nine hours of talks reflects the degree to which Rome may have miscalculated in the early stage of negotiations.

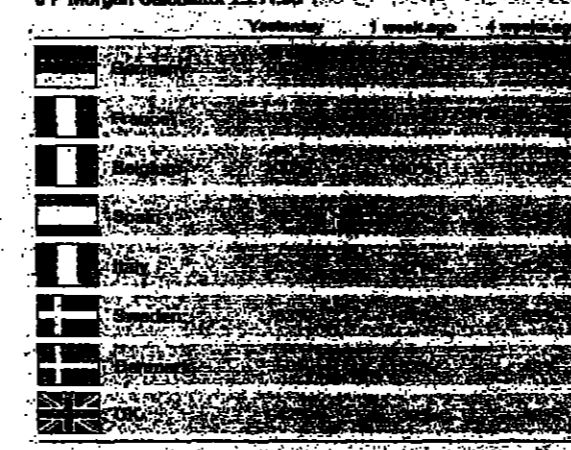
On Friday, Mr Ciampi was in Frankfurt attending a banking conference where he sounded out central bank governors and ministers. At this point, the Italian knew he had secured support from France and Germany for an entry level of around 1:1,000, according to Italian officials.

This followed intensive contacts between Rome and Paris, as well as Rome and Bonn. One crucial session took place in Naples between Mr Prodi and France's President Jacques Chirac who softened his attacks on the weak lira.

So, shortly after 4pm on Friday, Mr Prodi leaked news of the monetary committee meeting and announced that the lira would be rejoining the ERM within hours, if not days. It was then the first sign of trouble appeared. Mr Alexandre Lamfalussy, president of the European Monetary Institute, the precursor of the future European central bank, informed the Italian government that the bulk of his membership favoured a parity of 1980 to 1990.

After fruitless efforts to contact leaders in national capitals on Saturday night, Sir Nigel Wicks, the committee chairman, declared a stalemate. There was no alternative but to convene a meeting of EU finance ministers and

Emu: who's going to make it



The Emu calculator above provides a weekly snapshot of the probabilities which the financial markets place on selected countries being willing and able to join Germany in forming a single European currency in 1999.

Investors swap floating rate interest payments on an investment for fixed-rate ones. The probability which the markets place on France joining Germany in Emu can be calculated by looking at the current difference between French franc and D-Mark swap rates, and comparing it to the difference you would expect to see if Emu were postponed indefinitely.



Tietmeyer: stern words

replenishing its reserves. And he pointed out that the lira had been trading in the market consistently above 1:1,000 for the past few months.

"Ciampi gave the performance of his life," says an Italian diplomat. "If any other European minister had behaved like that, he would have been thrown out of the building."

Mr Tietmeyer complained about the Italian government's pre-emptive strike on the re-entry rate and the Bank of Italy's intervention. But as one participant pointed out, the differences had in effect narrowed to a range of 1980 to 1990 - or little more than 1:10 to 1:30 higher than the Italian government's demands.

The first sign of progress came just before 7pm when Mr Eddie George, governor of the Bank of England, left the negotiations. Without offering any details, Mr

George expressed confidence that an agreement would be ready before markets opened in the Far East.

At this point, Mr Ciampi contacted Mr Prodi who was spending the weekend in his home town of Bologna. The two men decided it was time to strike a deal.

A spokesman for Mr Prodi, noting that Italy's partners clearly believed that the "process of adjustment" was going better than appeared in the eyes of Italian public opinion, said one option for the government was a "hypothetical" value of 1980-1990 to the D-Mark. Within half an hour, the deal was struck at 1990.

One of the first lessons to be drawn from these events is that the dynamics of monetary diplomacy in Europe are shifting as a result of the structural changes in the European economy characterised by low inflation and high unemployment.

In the past, the Bundesbank has often pressed its partners to devalue their currencies against the D-Mark more than they wished. But at the weekend, Mr Tietmeyer, conscious of the competitive threat to German industry posed by an undervalued lira, argued for a revaluation of the lira beyond the level prevailing in the market.

"Emminger [Otmar Emminger, a former head of the Bundesbank] would be spinning in his grave," said one monetary official.

A second lesson is that the Franco-Italian consensus on the value of the lira suggests that the Paris government has calculated that it is safer to have Italy inside the ERM than outside.

Third, the weekend events leave the German-Italian dilemma over Emu unresolved. Bonn may have been relaxed about the entry terms for the lira into the ERM, but this does not set a precedent regarding the entry terms for Emu. Italy has achieved an important first step, but much more needs to be done before it stands a chance of entering monetary union in 1999.

Rome told of thorny Emu path

By Our Foreign Staff

Italy's return to the Exchange Rate Mechanism was yesterday welcomed in Paris and Bonn, but the Germans were quick to warn that Rome had much to do before it could be sure of participating in the final stage of European economic and monetary union.

Two of the three EU countries still outside the ERM, Britain and Sweden, said Italy's return would affect their decision to stay out. Both believe membership of the ERM should not and will not be a decisive condition for entry to Emu.

There was no official reaction from Greece, the other country outside the system, but observers believe Italy's return is viewed in Athens with trepidation as it signals Greece might be the only Mediterranean country to be excluded from the single currency in 1999.

Mr Theo Waigel, Germany's finance minister, said the German government would only enter the

final stage of Emu with countries which met in full the convergence criteria of the Maastricht Treaty and which held out the promise of enduring economic stability. His position was echoed by Mr Klaus Kinkel, the foreign minister, who insisted there would be no dilution of the entry criteria when, at the start of 1998, decisions were taken on which countries should be among the first Emu members.

Mr Waigel said the credibility in financial markets of Italy's convergence policy would be increased by rejoining the ERM. But Italy needed to implement its policy of budget consolidation in a determined manner and he stressed there was no automatic right to join the final stage of Emu.

In France, government and industry welcomed the lira's re-entry more out of relief at seeing Italy back within the disciplines of the currency grid than at the lira's relatively strong rate of re-entry. France, which has persistently and

publicly complained over the past four years of the damage wrought by a cheap lira on French trade, had earlier championed a rate of around 1:1,000 to the D-Mark. Mr Jean Arthus, the finance minister, was therefore all the happier to welcome the slightly stronger, agreed rate of the lira of 990 to the D-Mark as "fair, sustainable and durable".

Mr Romano Prodi, the Italian prime minister, was careful yesterday to reassure his own business community, which had been nervous that the new central bank for the lira would have a negative impact on exports. "It was a very well studied and balanced compromise which will not damage Italian industry," he told industrialists in the Veneto, one of the areas which has benefited most from a cheap lira these past four years.

Mr Arthus chose to stress that Italy's return increased the ERM's membership to 12 currencies and enlarged "the circle of [currency] stability".

The Patron employers federation echoed this in a statement, saying it "forcefully approved" the Italian move, which constituted "an essential step towards a return to exchange rate equilibrium in Europe".

The German government took Italy's decision as clear confirmation of Bonn's view that membership of the ERM is an essential pre-condition for full EU membership, thus serving notice on Sweden and the UK that they must also join if they want to be Emu members from 1999.

Mr Erik Asbrink, Sweden's finance minister, said Italy's entry would "not influence Sweden's decision on ERM participation". A UK Treasury official said: "Our position is clear: we do not intend to join the ERM and we cannot be forced to join."

In Greece Mr Yannis Papandonatos, the national economy and finance minister, said yesterday he was preparing the "toughest budget in 15 years" to ensure the country was ready for Emu.

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EMS parity grid. Bilateral central rates and buying rates in the EMS exchange rate mechanism from 25 November 1996. Table with columns for countries and various exchange rates.

Minister backs Eurofighter over Franco-German satellites

Rühe stirs weapons controversy

By Michael Lindemann and Bruce Clark in London

Mr Volker Rühe, Germany's defence minister and a man not known to mince his words, is at the centre of a political and diplomatic tug-of-war over priorities in arms procurement.

He insists, after months of wrangling, that funding for the Eurofighter, the four-nation £40bn (\$34bn) military aircraft, is back on track and that Germany's final decision about production investment - the money needed to prepare the factories which will build the aircraft - will be made by next March.

But, in a continuing argument with Chancellor Helmut Kohl, he insists that the beleaguered aircraft is so

important that there is no room for an ambitious Franco-German satellite project which Mr Kohl has agreed with President Jacques Chirac.

"[Eurofighter] is far more important for me as defence minister than the satellites," he said in an interview with the Financial Times last week. "There is no money for that in the budget."

Analysts, however, are still sceptical that Mr Rühe will be able to pull off Eurofighter financing and find an acceptable compromise on the satellites. Failure to do either would represent a considerable setback to efforts to consolidate the European defence industry so the stakes are high.

"He can get out of the satellite project, but only at a

very substantial loss," says Mr Sash Tusa, a defence analyst at UBS. "It will upset the French more than almost anything else."

Moreover, analysts say that Eurofighter financing is not going to be any easier next spring than it was two weeks ago when money could not be found in the defence budget. Meeting the Maastricht criteria for a single currency will guarantee continuing problems.

Mr Heinz Schulte, a defence analyst in Bonn, points out also that the political calendar is likely to interfere with Mr Rühe's plans.

By next spring, the candidates for the October 1998 elections will start jockeying for position and the Eurofighter will once again

become intensely political. "Prospective candidates will start to be asked whether they want more kindergarden places or a new fighter aircraft, and you can imagine what the answer will be," Mr Schulte says.

Making Eurofighter work, however, is a vital step towards a European arms industry and Mr Rühe's broader vision of a reformed Nato which includes a well defined European pillar.

The minister confirmed his support for the French view that Nato's south European command - hitherto headed by a US officer - ought to have a European in charge. Mr Rühe added that Britain, which has described the French position as unrealistic, should also be supporting Paris in a spirit of

European solidarity.

"It's not a question of getting a French admiral in there, but of a new Nato with a better balance," Mr Rühe said.

However, a meeting of Nato defence chiefs which ended in Brussels last week failed to bridge the gap between the US and France. The US is understood to have rejected a French compromise proposal under which the Naples command would rotate between Europeans and Americans.

This makes it unlikely that Nato's command structure reform - providing terms on which France and Spain can integrate their forces into the alliance - will be agreed this year, as Paris had originally hoped.

Editorial comment, Page 17

Belarus president claims mandate

By Matthew Kaminski in Minsk

President Alexander Lukashenko of Belarus yesterday claimed a broad mandate from Sunday's referendum, which his opponents in parliament said was illegitimate and a rigged "farce" to create a dictatorship.

Mr Seymon Sharetsky, parliamentary speaker, said Russian intervention was the only realistic recourse against Mr Lukashenko's plans to hand-pick a new legislature and high court. Parliament, the focus of the small opposition, will meet today. An impeachment motion, put forward by 76 deputies, remains before the constitutional court.

Demonstrations are also expected, but large public protests seem unlikely. Media coverage of the opposition's protest was muted last night and Minsk, the capital, remained quiet. The authorities claimed 5.1m people, or 70.5 per cent of all registered voters, endorsed the president's new constitution in the referendum.

Mr Lukashenko said that the two new houses of parliament and a new constitutional court "will be formed by Christmas". He also moved to split the opposition by inviting 120 current deputies, out of 199, to join the new 110-member lower house.

The upper house of 60 members, stronger than the lower, will be appointed by Mr Lukashenko and regional leaders. The president also gets an extra two years in office.

Informal observers from the European Parliament were not around to monitor Sunday's count but they noted irregularities.

Mr Sharetsky yesterday warned Moscow that the confederation with Belarus proposed under a deal reached earlier this year would bind Russia to a dictatorship.

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EUROPEAN NEWS DIGEST

Gdansk ship aid demanded

Workers at the bankrupt Gdansk shipyard, demanding government loan guarantees to finance the construction of six container vessels, yesterday occupied the local government headquarters building after a protest march through the city.

The yard desperately needs the \$100m guarantees to build the vessels for Columbia Ship Management, a Cyprus-based German shipowner. However, Mr Grzegorz Kolodko, the finance minister, is steadfastly refusing to secure the financing, which would come from local banks.

According to the yard, the shipowner has agreed to pay more for the vessels if the guarantees are forthcoming. The original prices failed to cover costs and contributed to the yard's current financial collapse. Completion would provide a chance of saving the yard and its 5,000 employees.

Christopher Bobinski, Warsaw

E German building setback

The east German construction sector, which until recently was the motor of the region's economy, is heading for a marked downturn, according to research by the Fraunhofer Institute for Economic Research (IWH).

Of 800 construction companies in the east, 49 per cent said they were optimistic about future business, against nearly 60 per cent last year. The IWH said the scaling back of federal subsidies was mainly to blame.

In a separate study, the IWH said east Germans remained less mobile than people in the west. Whereas 40.6 per cent of the west German labour force commuted to work in 1995, only 32.3 per cent did so in the east.

Frederick Stüdemann, Berlin

Leak embarrasses Madrid

The Spanish government, in the process of negotiating its place in a reorganised Nato structure, has been placed in an awkward position by the leaking of a classified alliance document.

The daily El Mundo yesterday published details from the annual "general intelligence estimate", which is circulated among allied governments. It focused on the risk from Libyan medium-range missiles carrying nuclear, chemical or biological warheads which could be produced within the next 10 years. It quoted the document as warning about plans for chemical weapons production at an underground complex at Tarhuna, east of Tripoli.

Nato and Spanish officials declined to comment on the report. Although defence analysts saw nothing surprising in its assessment, publication comes at an embarrassing moment as Spain is about to upgrade its status in Nato. Parliament voted last week to endorse the centre-right government's plan for full integration in the alliance's new military organisation, details of which are still under discussion.

David White, Madrid

Hungary sets TV bids date

Foreign companies can start bidding for commercial television and radio stations in Hungary from December, a senior media official said yesterday. Two commercial TV and two radio stations are to start broadcasting next September. The primary owner of each will be allowed to hold up to 49 per cent, and the secondary owner up to 25 per cent, of the stations, with a minimum of 26 per cent remaining in Hungarian hands.

AP, Budapest

Thousands take to streets over Serbian polls

By Laura Silber in Belgrade

The Serbian opposition yesterday mustered 100,000 protesters on the streets of Belgrade in the biggest demonstration so far against attempts by President Slobodan Milosevic to annul its victory in local elections.

Angered by the latest court decision, which cancelled an opposition win in Belgrade, demonstrators of all ages and backgrounds brought the capital to a standstill, chanting "Down with the red bandits". "We won't give up our victory", and "Slobo, Saddam". The crowd streamed past the symbols of Mr Milosevic's regime, hurling eggs at his office, Television Serbia, and the Serbian parliament.

"People are defending their civil rights. It doesn't even mean they support the opposition: now they are defending their dignity,"

said Mr Zoran Djindjic, president of the opposition Democratic party, who could have been Belgrade's first non-Communist mayor since the second world war.

Acting on complaints by Mr Milosevic's Socialists, a court reversed an official ruling which gave the opposition 50 of 110 seats in Belgrade's city council. Opposition leaders say they will boycott a run-off in municipalities previously confirmed as won by their coalition Zajedno (Together).

Thousands of students went on strike, marching down the capital's main street to join the protest.

The landslide opposition victory in 15 of Serbia's 18 biggest towns on November 17 took Mr Milosevic's Socialist regime and western governments by surprise. Once seen abroad as the man most responsible for the war in Bosnia, Mr Milosevic



Demonstrating Belgrade university students wave their report cards as part of a protest at the annulling of local poll results.

is now a pillar of the Dayton peace agreement. Opposition leaders accuse the west of supporting him.

Mr Richard Miles, the US chargé d'affaires in Belgrade, yesterday insisted the US was maintaining a tough stance.

"I have heard a lot in recent days about... exerting more direct pressure on

President Milosevic and I would just note that already the US does not have normal diplomatic relations with Yugoslavia, that is to say Serbia and Montenegro," he told Radio B-92, the only independent station in Belgrade.

"The US has imposed and is maintaining the so-called outer wall of sanctions," he

said, referring to conditions agreed in Dayton which Yugoslavia must meet before it is allowed to join international organisations and financial institutions.

Diplomats yesterday said the EU was poised to postpone until next month a decision on preferential trade status with Serb-led Yugoslavia.

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NEWS: EUROPE

Erbakan turns the screw on Turkish media

After months of warnings, Turkey's Islam-led coalition has decided to act against the media, calling a debate today in parliament to discuss tighter regulations.

Intense interest in a bizarre car crash involving a gangster, a top policeman and a government MP has prompted the PM to act, writes John Barham

car accident three weeks ago that threw light on links between the government, the security establishment and rightwing gangsters.

Bucak's bodyguards with the security forces and under world shootings. Mr Bucak made no effort to hide his friendship with Mr Cilli.

The government has not announced its plans in detail. Ministers say they want an initial debate before returning with draft legislation for formal discussion.

instance, spending on advertising would no longer be tax-deductible. MPs will probably also tighten up on the individual's right of privacy and right of reply.

nationalistic reporting, helping distract attention from Turkey's economic problems. The mainstream press gives little space to journalists questioning the 12-year war against the Kurdistan Workers party.

and radio stations off the air for broadcasting reports that embarrass the government.

Portugal to open telecoms by 2000

By Peter Wise in Lisbon

Portugal is to liberalise all telecommunication services by 2000 and set up a second national operator, ending Portugal Telecom's monopoly control of infrastructure and basic telephone services.

Complicity in abuse of office alleged over food company sale Call to charge Italian PM

By John Simkins in Milan

The messy break-up of SME, Italy's state-controlled food company, in 1988-94 returned to haunt Mr Romano Prodi, the prime minister, yesterday when a Rome magistrate asked for him to be charged for complicity in abuse of office over the affair.



Prodi: 'I shall clarify everything as always.'

1980s. The privatisation of CBD was particularly tortuous. In July 1993 the Italian arm of SME was sold to Nestlé, while CBD was put out to tender in the absence of adequate offers for the group.

New postal proposals test Brussels' nerve

By Neil Buckley in Brussels

The European Commission is facing a test of its determination to open parts of the EU's €555bn (\$75bn) postal market to competition, as Germany and France try to steer through a compromise which is far short of original proposals.

decision by ministers. If it blocked the compromise, Brussels could adopt officially a notice on how it intends to apply EU competition law to the postal sector.

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Advertisement for Linnco, a 'one stop' brokerage connection to the world's futures, options & forex markets.

A vertical column of financial advertisements including 'Union Limited', 'Berkeley Futures Limited', 'Market Eye', 'Knight-Ridder's Futures Market Datarun', 'Shares - Tax Free', 'Fast Fills, Low Rates', 'Offshore Companies', 'City Index', and 'Petroleum Argus'.

NEWS: INTERNATIONAL

Geneva conference hears that risks of germ warfare and terrorism are thought to be growing
Talks aim to curb biological weapons

By Frances Williams in Geneva
 Representatives from nearly 140 countries yesterday began a two-week meeting in Geneva with the aim of strengthening a global pact banning biological weapons, amid warnings that the risks of germ warfare and terrorism are increasing.
 The main focus of the conference, the fourth regular review of the 1972 biological weapons convention, will be the need to negotiate a set of

anti-cheating measures to detect and prevent violations. The United Nations treaty, which was the first to ban a whole category of weapons, has no provisions to check compliance.
 Negotiators have been working on a verification protocol since 1994 but have failed to agree the scale and scope of measures required. The US and other western nations are hoping the Geneva conference will set a target date for completion of the protocol by 1998.

However, countries are split on the scope, scale and intrusiveness of the future verification system, which threatens to delay the talks beyond 1998. Many developing countries are concerned that on-site inspections could allow snooping around unrelated military facilities. There are also problems in ensuring that commercial secrets of private companies are adequately protected.
 Now that intricate verification procedures have been agreed for the treaty on

chemical weapons, due to come into force next April, and for the just-signed nuclear test ban, disarmament experts fear biological weapons may present a growing attraction for rogue states and terrorist groups.
 Since the last review conference in 1991 Russia and Iraq, both treaty members, have admitted to possessing biological arms and there are suspicions that development programmes may be continuing.
 Aum Shinrikyo, the Japa-

nese sect which used chemical agents in its deadly attack on a Tokyo subway last year, was also apparently trying to develop a biological weapons capability. There are even claims it sent a team to Zaire to help with an Ebola outbreak in 1992 with the objective of collecting a sample of the virus.
 According to a 1993 report compiled by US intelligence, China, Iran and Syria also possess biological weapons and Egypt, Taiwan and Libya may have them. Brit-

ish officials say that up to 10 states may have biological weapons, though Mr Sha Zukang, China's disarmament ambassador in Geneva, insisted yesterday that his country was in full compliance with the treaty.
 Biological weapons are harder to detect than nuclear or chemical arms because they can be easily produced and stored in tiny quantities. Agents causing anthrax, plague and botulism occur naturally and can be grown in a laboratory.

Algerian military votes on party ban

By Rouda Khatat
 Algeria's army and security forces voted yesterday in a controversial referendum on amending the constitution.
 The early vote will allow a heavy deployment of security forces when civilians vote on Thursday.
 The referendum proposes a change to the constitution by banning parties from using religion to further their political ends.
 It was the imminent victory of an Islamist party fiercely opposed to the Algerian military which prompted the army to cancel the second round of legislative elections in 1992. Since then, Algeria has been plunged into a cycle of violence which has claimed more than 50,000 lives.
 The new constitution aims to prevent any single party challenging the state again. It proposes to expand the powers of the presidency by setting up a second chamber of parliament, with a third of its members designated by the president.
 The army-backed Algerian government holds up the referendum as a vital step in the building of democratic institutions. But many in the opposition see it as an attempt to create a facade of democracy while institutionalising totalitarianism.
 The government has relentlessly campaigned to convince the 15.4m eligible voters to cast "yes" ballots. Some opposition groups have called for a boycott, others for a "no" vote. Legal Islamist parties are leaving the choice to their supporters.
 Opposition leaders, including Mr Hocine Ait-Ahmed of the Socialist Forces Front (SFF), and representatives of the Islamic Salvation Front (FIS), the banned Islamic party which was stripped of an election victory in 1992, issued an appeal for peace in Brussels yesterday and urged voters to vote "no" or to boycott the poll.

UN near to deal on Iraqi oil sales

By Michael Littlejohn, UN Correspondent, in New York
 Iraq and the United Nations yesterday appeared close to agreement on a plan that will return \$2bn worth of Iraqi oil to the world market over six months.
 News of imminent implementation of the deal agreed with the UN in May sent benchmark light crude oil prices down almost 40 cents to \$22.66 a barrel.
 A Security Council sanctions committee has yet to approve a pricing formula that would trigger the resumed flow of Iraqi oil.
 Ms Sylvana Poa, the UN press secretary, said some details still had to be concluded, including certification that damaged mastering equipment was working.
 Mr Boutros Boutros Ghali, the secretary-general, expected to report favourably to the Security Council in a matter of weeks.
 Mr Nizar Hamdoon, Iraq's UN delegate, who delivered Baghdad's response after months of haggling, said that all the conditions set by the UN had been met except for a pricing formula.
 The US has been the main obstacle on that issue but officials said Washington was unlikely to stand in the way now that the American elections were over. Iraq and the US have also agreed over the number of foreign and Iraqi observers who would be allowed to inspect the distribution of humanitarian supplies. Iraq has sought to restrict the observers' freedom of movement.
 The UN put the deal on hold in September after Iraqi troops assisted a Kurdish faction in recapturing the administrative capital of Arbil in the Kurdish enclave. The shortage of food and medicine is estimated by Unicef to have led to the deaths of 4,500 children every month from hunger and disease.
 Opec meeting, Page 32

More work needed on the concept of full employment

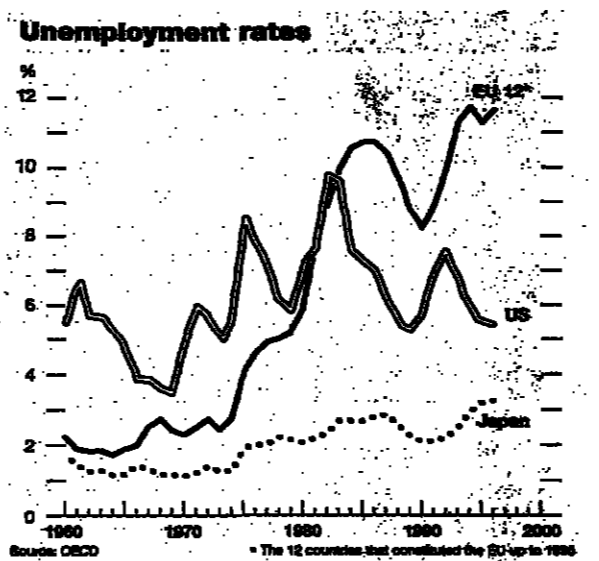
The ILO's annual report argues the current world jobless rate is neither politically nor socially sustainable, writes Robert Taylor

One billion people, 30 per cent of the world's workforce, are either jobless or underemployed, according to the Geneva-based International Labour Organisation.
 In its annual employment report, published today, the ILO argues a renewed commitment by national governments to the concept of full employment with a sustained annual global growth rate of more than 3.5 per cent could help to resolve the crisis. The report says that full employment is "not passé" but "still feasible and highly desirable".
 "Current levels of unemployment make no economic sense and are neither politically nor socially sustainable," said Mr Michel Hansenne, the ILO's director-general yesterday.
 "It is not just heartless but pernicious to assume nothing can be done to remedy unemployment, that so-called jobless growth [when a country's gross domestic product grows with no substantial jobs growth] is the best that can be hoped for in an increasingly competitive economy or that cur-

rent unemployment rates somehow constitute a natural and inevitable outcome of market forces."
 The report seeks to demolish a range of assumptions about world employment. "It is not true globalisation is an uncontrollable supra-national force that has largely usurped national policy autonomy," it says. According to the ILO the nation state is "still the dominant influence on economic and labour-market outcomes. Global financial markets punish unsound macro-economic policies which are, in any case, undesirable in their own right". It adds, "The empirical evidence suggests trade with developing countries and the relocation of industries has been only a minor explanatory factor behind the rise in unemployment and the declining wages of unskilled workers in industrialised countries."

The report questions the popular view that the world is running out of jobs. "Much of the 'end-of-work' literature rests on unwarranted extrapolations from dramatic episodes of corporate downsizing, ignoring job creation elsewhere in the economy." The ILO says the employment growth rate has remained "almost unchanged over the last three-and-a-half decades and has not slowed down significantly since 1973", with the pace of job creation remaining steady in the face of the reduced economic growth rate of the 1970s and 1980s.
 Nor does the ILO accept job changes are becoming more frequent and employment more unstable, saying there has been an increase, not a decline, in the length of job tenure. "On average, individuals currently employed have been in their jobs for six to 12 years,

depending on the country and this figure has not been declining," it says. Only in Spain have job moves become increasingly frequent, "probably because of institutional changes".
 The report doubts whether "labour market imperfections" are "either the main or the sole cause of the upward drift in European unemployment," although it does not suggest they have had no effect. "Labour market rigidities have not been increasing over the period of rising unemployment," says the ILO.
 It says the main "underlying" cause of increased unemployment is the slow-down in economic growth since 1974. It also criticises the rise in wage inequality, particularly in the US, UK and New Zealand, which it argues is partly due to the decline in trade union density and decentralisation of pay bargaining.
 The report states: "There is no convincing evidence that it is supply-side constraints, rather than a deficiency in demand that have caused the prolonged period of low growth." It adds:



"Higher growth is possible provided a sustained period of expansionary policies is supported by credible policies to prevent a resurgence of inflationary wage increases and to overcome the skill shortages that will be generated. Without this the expansionary impulse will indeed be choked off by the reaction of the financial markets." The ILO calls for a return to co-ordinated pay bargaining, the creation of social pacts between unions and employers, as well as the encouragement of profit sharing or "some form of tax-based incomes policy if there are no better alternatives". It wants more efficient labour market policies with subsidies for low wage employment, training focused on the most dis-

vantaged, incentives for recruiting long-term jobless and improved benefit transfer programmes linking benefits and work more closely together.
 The report says developing countries should also be committed to full employment and it argues this can be achieved by creating more open and competitive economies that benefit fully from expanding trade and investment flows in the global economy. The ILO believes, however, the "trickle-down effects of market reforms will be weak unless they are accompanied by programmes to strengthen the productive capacity of the poor" through improvements in rural infrastructure, education and health services.

Portugal to open telecoms by 2000

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Africans forge closer trading links

South Africans are looking north for trade and investment opportunities, writes Mark Ashurst

Between Pretoria and Cairo there are only five manufacturers of car tyres. Few statistics better illustrate the sparseness of Africa's manufacturing base, or its appeal to South African exporters. Faced with rising competition and the dismantling of protective tariffs at home, many manufacturers hope mainland Africa will provide a fillip for their fledgling export businesses.

Trade has been most brisk in East Africa - particularly Kenya, where combined imports and exports last year reached a record R1bn (\$212m). Exports have increased fourfold since the end of apartheid in 1994, as the cheaper transport costs of goods from South Africa have prompted a shift in regional economic allegiances. According to Mr Christopher Hartland-Peel, African equities analyst at Standard Bank in Johannesburg, South Africans are gradually displacing Euro-

pean investors in Central and East Africa. Analysts expect the number of joint ventures between South Africa and Kenya, the continent's most industrialised nations, to mushroom next year. Spoonet, South Africa's state-owned rail group, has reached a technology transfer agreement to supply computerised data systems to Kenyan rail freight operators. And most South African exporters of steel, chemicals, plastics, polymers and foodstuffs have appointed full time agents in Kenya within the last two years.

"We are getting to understand the country and the economy," says Mr Stan Shaw, manager of East African trade at CGIC, South Africa's credit guarantee agency, which is helping to set up a sister organisation in Nairobi. Significantly, much of the new activity is in labour-intensive, value-added industries where South Africa has battled to

gain a foothold in more developed markets.

South African cars, for example, remain uncompetitive in world markets - largely due to the short production lines developed behind high protective tariffs during the sanctions era. But exports of individual components are flourishing. Lomrho's Nairobi subsidiary now distributes Toyota parts from the company's South African plant, after many years of importing them from the Far East. In the first four months of 1996, exports to Kenya of vehicles, machinery, base metals, and chemicals comprised about 60 per cent of total non-mineral exports worth R2.4bn.

Mr Tony Wright, general manager of Africa banking at Standard Bank, says exporters welcome trade with Kenya because of its relatively low sovereign risk and stable foreign exchange reserves. But measures to curb corruption have not kept pace with economic

reforms: "There is always the risk of a heavy whip in the background." He cites neighbouring Tanzania, where trade volumes are significantly smaller but economic reforms have outpaced Kenya, as a model for attracting direct investment.

Tanzania is now rated an "A-grade country" by Randgold, the South African mining group which grades African states by their suitability for investment. "The macroeconomic picture is very important to us, because mining is long term," says Mr Mark Bristol, managing director of Randgold Resources. He is encouraged by new mining legislation that welcomes foreign capital, and the authority's strict action to curb illegal mining at Balvanhulu earlier this year. "The government has seen the benefits of what we do."

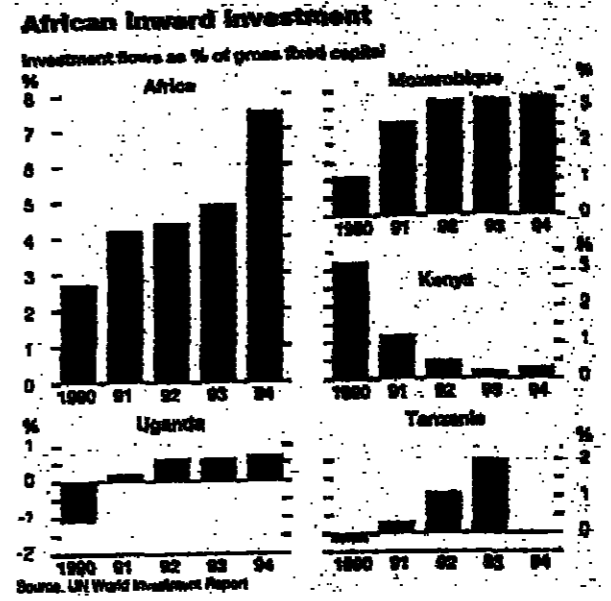
As the worldwide scramble for African mining rights gains momentum, South African mining houses have

been at the forefront of exploration in Tanzania. The country produces only 0.9 per cent of Africa's gold, but feasibility studies by gold miners Anglo American, JCI Ltd and Randgold are all at an advanced stage. Randgold, which last year entered a joint venture with Fanga Goldfields, the Canadian exploration company, will invest about \$4.5m to develop a 1.5m ounce ore body at Lake Victoria.

The trend of consolidation in global industries is a further catalyst for South African companies to forge a path in Africa. Engen, South Africa's biggest oil retailer, last month announced a R100m investment in an oil terminal at Dar es Salaam, its biggest investment in Africa to date. The deal grants Engen access to a further two inland refineries and an option to bid for a network of retail fuel stations. It also furthers the

ambitions of its biggest shareholder, Petronas, the Malaysian state-owned oil and gas company which wants more exposure in mainland Africa. Mr Rob Angel, chief executive, is "confident a deal can be done" to enter the Tanzanian retail market.

Arguably, the greatest catalyst for investment from South Africa is privatisation. The best example is Tanzania Breweries, which was partially privatised in 1993, enabling SAB to acquire a 45 per cent stake and a five-year management contract. Its market share has increased from 25 per cent to 75 per cent, and the brewery posted its first profits this year. South Africans can create a partial barrier to entry for European rivals by using refurbished equipment as part of its equity, says Mr Robin Smith, financial director of South African Breweries' international brewing interests.



investment - particularly joint ventures - is vital to counter resentment caused by the massive imbalance of trade. Last year, South African exports to Kenya were worth R940m, compared with imports of R111m. In Tanzania, the trade gap was a gargantuan R811m on imports worth R627m - an increase of 340 per cent from R188m in 1994.

The weaker rand is likely to widen the trade gap this year, while the hands of South African investors are tied by exchange controls. But in time, the gradual easing of these restrictions will favour a flow of South African capital to East Africa. Lower labour costs and comparatively stable currencies will become a magnet for South African manufacturing industry, says Mr Hartland-Peel.

China offers to cut tariffs to 15%

By Sophie Roell in Beijing

China yesterday reiterated its undertaking to reduce import duties to an average of 15 per cent by the year 2000, in a second round of tariff cuts intended to demonstrate its commitment to trade liberalisation and boost its chances of a quick entry to the World Trade Organisation.

The Chinese president, Mr Jiang Zemin, attending the Apec forum in the Philippines, confirmed China's

intention to reduce tariffs - which currently stand at an average of 23 per cent following a reduction of 12.9 per cent earlier this year.

However, observers were sceptical about how much the tariff cuts had achieved. A European diplomat said that while on average tariffs had been brought down, those on particular product groups, such as cars, were still punishingly high. "These are the areas in which European exporters are strong," he said.

The lowest tariffs have tended to be in sectors such as raw materials, which are of less interest to western exporters, he said.

The European Union is understood to be waiting for China to bring tariffs down to an average of below 10 per cent before endorsing the country's WTO entry.

Diplomats have also criticised the myriad quota restrictions still in place, and licensing requirements which bar access to the Chinese market - particularly

in the service sector. China's state-owned media however have been publicising the country's exemplary stance on trade liberalisation, and arguing the case for a quick entry to the WTO.

The China Daily noted that China's tariff cuts had achieved in a "single stroke" a Uruguay Round requirement that signatories cut their customs duties by one-third within five years.

Nevertheless, in recent months there has been more

optimism about getting talks on China's entry to WTO back on track. One analyst referred to a "new momentum" in negotiations, prompted by a somewhat softer US stance, and the apparent determination of the Chinese leadership to "breathe new life" into its efforts to join WTO.

"I think there will be greater progress next year, though China still has some way to go before either the US or Europe is satisfied," he said.

Europe in telecoms deal with S Korea

The European Union and South Korea have struck a deal to throw open their telecommunications equipment markets to each other's suppliers. Reuter reports from Brussels.

"European companies will now be treated as fairly as their Korean counterparts when bidding for contracts to supply telecoms equipment to the network run by Korea Telecom," the European Commission said in a statement.

The deal also gives Korean suppliers equal access to contracts in Europe's \$22bn-a-year market. The Commission said it would withdraw the dispute procedure begun against Korea in the World Trade Organisation if EU ministers, who have the final say on the accord, give it a green light.

The deal covers contracts in Korea's \$6bn telecoms equipment market awarded by both state-controlled Korea Telecom and by newly licensed private operators, the Commission said. Korea Telecom accounts for 80 per cent of the country's telecoms network market.

"Today's breakthrough, which follows over two years of intense negotiations, applies mainly to switching and transmission equipment and cables," the Commission said. Korea pledged to end legislation and practices that discriminate against European products, while the Commission agreed that the EU would waive a provision in its "utilities directive" that gives preference to European telecoms products.

That directive allows public agencies to reject bids when products are less than 50 per cent EU origin. It also requires them to prefer EU bids over other equivalent bids if the price difference is no more than three per cent.

Suppliers will have the right to challenge contract awards in national courts and the two sides will use a binding dispute-settlement mechanism to resolve disagreements over implementation of the accord, it said. The Commission said the deal should make it easier to conclude a proposed global world Information Technology Agreement, which aims to eliminate tariffs on a wide range of computer and telecommunications equipment.

WORLD TRADE NEWS DIGEST

Suez Canal cuts prices

The Suez Canal is to give discounts to certain vessels from next year because of increasing competition from oil pipelines and other shipping routes. Oil tankers carrying up to 3m tons will receive discounts of 5 per cent to 30 per cent on fees for using the canal, according to Mr Ali Ahmed Fadel, head of the Suez Canal Authority.

Liquefied natural gas carriers will obtain discounts of up to 35 per cent while certain container ships will also be granted reductions, he said. The canal, which opened in 1869, is one of Egypt's main sources of foreign currency. Mr Fadel said that market studies indicated that the new fees should help increase canal revenues by between 5 and 10 per cent in 1997. Revenues for the first half of this year were \$323m against \$348m in the same period of 1995.

Sean Ewers, Cairo

UK fosters S American trade

The UK government hopes to promote greater trade and investment with Latin America with a one-day conference in London on February 10. It hopes some Latin American heads of state will speak at the conference, as well as ministers and senior businessmen. Mr Ian Lang, left, president of the Board of Trade, said that although Britain was the largest investor in the region after the US, many companies still overlook what is the fastest growing region in the world after south-east Asia. Britain's share of exports to Latin America is only 1.7 per cent, well below its 4.5 per cent share of world trade.

Stephen Fidler

Telstra wins Hilton contract

Telstra, the Australian government-owned telecommunications group, has secured a three-year deal to supply telecoms services to the Hilton International hotels group.

Services will include the hotel group's internal network, and also the facilities provided to visitors, including video-conferencing between hotels. Nicki Tsai, Sydney

Egyptian order for Rolls

Rolls-Royce company Peebles Electric has won an \$2m (\$13.6m) order to supply power generation equipment to an Egyptian chemical plant. Peebles will provide equipment for the 17.7MW combined heat and power scheme at the Talkha II urea plant in northern Egypt. The plant has been ordered by Société El Nasr d'Engrais et d'Industries Chimiques (Semadco), the state company for fertiliser and chemical utilities, to provide electricity and steam for production purposes.

Rolls-Royce Aerospace Group recently won an order worth up to \$450m for RB211-S35 engines to power a batch of Tupolev Tu-204 aircraft ordered by the Kato Group of Egypt.

Foreign Staff

Arvin Industries of the US, an international vehicle component maker, and Kayaba Industry of Japan, a power steering pump producer, have agreed to form a joint venture to manufacture and sell power steering pumps to European car manufacturers. The new company will be based in a new plant in Pamplona, Spain, and will begin production next year.

Reuter, Columbus

CAE, the Canadian electronics group, will build a \$2m automated control system for Sichuan Electric Power of China. The system will manage output and distribution from two hydro-electric stations with total capacity of 1,300MW. CAE has sold six similar hydro control systems to China since 1985.

Robert Gibbens, Montreal

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Peru deal on MiG jets confirmed

By Sally Bowen in Lima

President Alberto Fujimori of Peru has confirmed the purchase of an unspecified number of Soviet-built MiG fighters, an acquisition that has led Ecuador to suggest that Peru's neighbours might be obliged to buy new arms themselves.

Mr Fujimori in a television interview late on Sunday night spoke of a "fleet" of MiG-29s, which will be the first such fighters in any Latin American country. However, he refused to specify the quantity or the price paid.

Mr Frank Vargas, Ecuador's minister of the interior said the Peruvian acquisition would "oblige other countries, especially [Peru's] neighbours, to buy new arms."

Mr Fujimori said the purchase of new arms had meant withdrawing "several hundreds of millions of dollars" from the budget. That meant "fewer resources" and "less disposable cash" for the internal economic programme.

The Peruvian economy, originally projected to expand by 3.5 per cent to 4 per cent this year, is now barely on target for 2.5 per cent growth.

The MiG purchase represents something of a volte-face for Mr Fujimori who - since becoming president for the first time in 1990 - has insisted at home and abroad that priority expenditure was for poverty alleviation, not weapons.

It seems likely, however, that pressure from the highest levels of the armed forces - still smarting from their poor showing in the February 1995 border conflict with neighbouring Ecuador - has finally proved irresistible.

Reliable details are still scarce, but the MiG deal is believed to have been struck with Belarus, which has a large stock of Soviet-built jet fighters inherited when it gained independence with the break-up of the Soviet Union.

According to Mr Fujimori, the acquisition will "help in re-establishing the strategic equilibrium" and is a "purely defensive measure".

Peru lost nine aircraft during the Ecuador conflict, while the Ecuadorians lost a maximum of two.

The US, one of the four guarantor countries of the 1992 Rio de Janeiro Protocol, which is the framework for continuing Peru-Ecuador peace talks, has expressed official regret at the Peruvian arms purchase.

However, Mr Fujimori said there was no reason for US surprise: Ecuador, after all, recently acquired a number of Israeli Kfir fighters, also justified on the grounds of replacing old equipment.

Ottawa fans tobacco advertising flames

Bernard Simon explains why government efforts to agree a ban have aroused such passion

Canada's Liberal government knew it had been handed a hot potato in September 1995 when the supreme court struck down a ban on tobacco advertising.

But the landmark ruling has produced even more heat than expected. More than a year later, the government has yet to carry out its promise to pass a new law.

Its efforts have been bogged down by discord among individual cabinet ministers and departments. Furthermore, proposals to widen the advertising ban to include tobacco company sponsorships have aroused local protests from hundreds of cultural and sports groups.

The latest delay came last week when Mr David Dingwall, the health minister, cancelled plans to unveil a new anti-smoking bill.

Mr Dingwall changed his mind after news leaked out that the measures would include a rise in cigarette taxes. The leak raised concerns that distributors would reap windfall profits by stockpiling supplies.

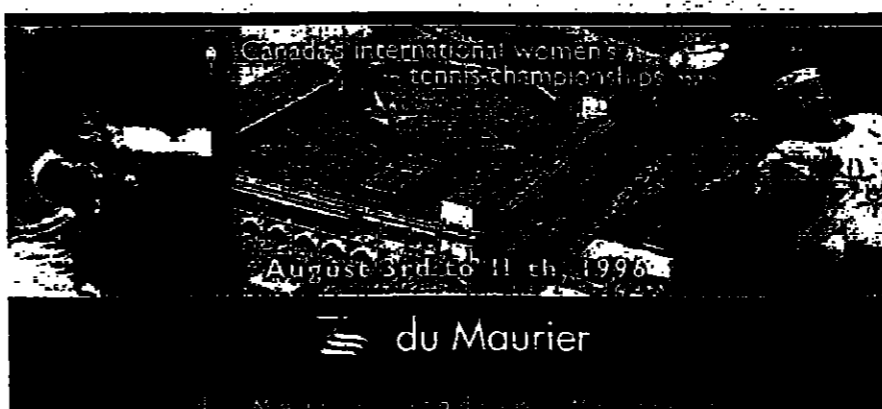
The original Tobacco Products Control Act, enacted in 1988, was one of the world's toughest anti-smoking laws. It included a blanket provision that "no person shall advertise any tobacco product offered for sale in Canada."

The law barred the use of tobacco trademarks on products such as T-shirts, and required tobacco companies to put prominent health warnings on cigarette packs.

But the supreme court, responding to a challenge by local subsidiaries of US-based RJR Nabisco and the UK's Imperial Tobacco, ruled that the act violated the tobacco industry's constitutional right to freedom of expression.

The court indicated that some curbs on tobacco advertising might be permissible. But they would have to be based on "minimal impairment" of free speech. The ruling has cleared the way for tobacco companies to resume advertising within a self-imposed code of conduct.

Mr Dingwall, a combative and ambitious minister, has



Imperial Tobacco has tagged the Maurier brand on to Canadian Open tennis championship

been under heavy pressure from health groups not only to reimpose the advertising ban, but to find new ways of clamping down on smoking. Sponsorship has been a tempting target. The act permits sponsorships, but only under company names, not brands.

However, the industry has found ways of getting its message across. Imperial Tobacco registered four new companies under the names of flagship brands.

For instance, the name "du Maurier" has been tagged on to the Canadian Open tennis championship. A spectacular annual fireworks display at Ontario Place in Toronto is now known as the Benson &

Hedges Symphony of Fire.

But the moves to toughen the anti-smoking law have run into obstacles. Some 250 arts and sports groups that benefit from tobacco sponsorships have formed an Alliance for Sponsorship Freedom.

Mr Max Beck, Ontario Place's general manager, estimates the groups receive about C\$60m (US\$45m) a year from the tobacco industry, with marketing and promotional support adding roughly C\$200m more.

Mr Bob Moffatt, president of Tennis Canada, says: "All of us are very sensitive to the smoking issue. But we've not been convinced that the objective will be reached by removing sponsorships."

The tobacco industry is also mobilising retailers who would be hit by provisions, said to be under consideration in Ottawa, to limit behind-the-counter displays of cigarettes to one pack of each brand. Tobacco manufacturers pay retailers about C\$80m a year in "display allowances".

Mr Dingwall's proposals have also sparked friction within the Liberal caucus, especially with Mr Paul Martin, finance minister.

Questions have been raised about the wisdom of raising cigarette taxes less than three years after they were sharply cut to stop smuggling across the US-Canada border.

lobbyist, the finance department has shot down a proposal to channel a portion of cigarette taxes into a fund that would replace tobacco company sponsorships.

Arts and sports groups have made no secret of their frustration with Ms Sheila Copps, the heritage minister, who supposedly represents them. "She has not been there for us," Mr Beck says.

Despite the delays and disagreements, Mr Dingwall is widely expected to table the new bill before the House of Commons rises for its Christmas recess. However, the bill's critics are unlikely to give up without a fight.

The sponsorship community plans to press its case at parliamentary hearings, through individual MPs and, possibly, through legal challenges.

The tobacco industry is sceptical that a tougher law can meet the criteria set out in last year's judgment.

Mr Rob Parker, president of the Canadian Tobacco Manufacturers Council, says: "We don't think the politicians and bureaucrats understand the implications of the bill."

It would thus come as no surprise if the supreme court once again ended up deciding how far politicians can go in their anti-smoking crusade.

AMERICAN NEWS DIGEST

US set to cut phone charges

The US's main telecommunications regulator is expected today to take the first step in its efforts to bring down international telephone charges. Its action could have an impact in particular on rates of calls between the US and the UK, easing the way to lower prices on transatlantic calls.

The change due to be considered today by the Federal Communications Commission would loosen the regulatory regime for international telephone traffic between the US and certain countries. It would apply only to those which the US believes have competitive domestic telephone markets. The group is likely to include the UK, Canada and Sweden.

The change would allow carriers in the US and the countries concerned to negotiate freely on the terms under which they complete each other's calls, introducing a new element of competition into international traffic. At present, the US imposes restrictions on such arrangements.

The rule change is seen in part as a response to the UK's plans to allow companies other than British Telecommunications and Cable and Wireless to carry international calls into the UK. New competitors would be able to compete more aggressively to carry calls from the US, without being under any obligations to US carriers.

Richard Waters, New York

Mexican airport in drugs row

A Mexican admiral has accused former employees of the National Airport Authority in Cancun, the country's top tourist destination, of supplying jet fuel to drug traffickers who use the busy airport as a stopover while transporting cocaine from Colombia to the US.

Admiral Enrique Sangri Namur, director of Cancun's international airport, told El Universal, the Mexico City daily, that 19 employees had been fired after the discovery of fraudulent invoices which sought to conceal the sale of jet fuel to the aircraft of drug traffickers.

"Cancun has supplied fuel surreptitiously to drug traffickers for many years," the admiral, who took over the administration of Mexico's second busiest airport in 1995, was quoted as saying.

Admiral Sangri Namur was not available for comment yesterday. Mr Leonel Soda Sanchez, a union official who made similar accusations against the airport officials, was murdered in 1996.

Officials at the National Airport Authority's headquarters in Mexico City, however, confirmed that 19 airport employees had been sacked recently, but were surprised at the admiral's press comments.

"The 19 employees were fired for administrative offences," a spokesman for the National Airport Authority, said yesterday. The drug trafficking allegations come at a particularly embarrassing time for the National Airport Authority, which is being prepared for privatisation.

Leslie Crawford, Mexico City

Chemical groups lift spending

US chemicals companies plan to increase spending on plant and equipment by 5 per cent annually for the next two years, following an 8 per cent increase in 1996, according to the preliminary results of a survey* by the Chemical Manufacturers' Association (CMA), a US industry group.

These plans are based on expectations of 5 per cent sales growth in 1997 and a 10 per cent increase in net operating income, according to the survey. However, there are signs that some of the survey's projections could prove too optimistic. Companies are projecting export growth of 5 per cent in 1996 and 6 per cent in 1997, but official US trade data show export gains of only 1.3 per cent for the first eight months of this year.

Historically, the chemicals industry has tended to invest in new plant and equipment at the peak of its earnings cycle, leaving it with excess capacity when the market weakens. The CMA predicts that 1996 profits for the US chemicals industry will total \$35bn-\$37bn, roughly in line with last year's \$35.8bn, following several years of strong profits growth.

Tracy Corrigan, New York
*The US Chemical Industry Performance in 1996 and Outlook, from the Chemical Manufacturers' Association, 1300 Wilson Boulevard, Arlington, VA 22209, USA.

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Group share	US\$1.5 billion
Group share	US\$1.5 billion
Group share	US\$1.5 billion
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Group share	US\$1.5 billion

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Disruption to services will trigger compensation to national railway companies

Payout news depresses Eurotunnel shares

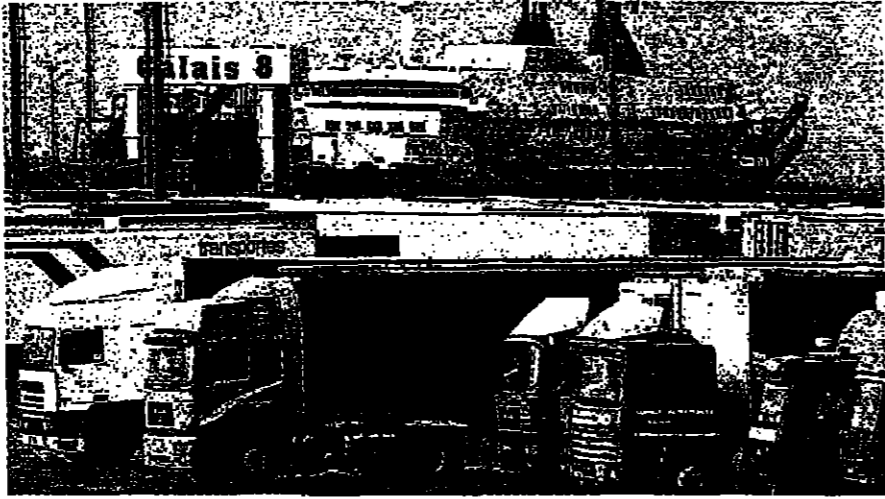
By Charles Batchelor in London and Andrew Jack in Paris

Eurotunnel's shares fell 5 pence to 81 pence in London yesterday on the news that the company faces the prospect of paying substantial compensation to the three national railways which operate the Eurostar passenger service following the fire on Monday last week.

Eurotunnel is the operator of the Channel tunnel between England and France.

The contract which sets out the commercial relationship between Eurotunnel and Eurostar includes provision for payments when the service is interrupted. Eurotunnel said in Paris yesterday.

However, both companies refused to confirm suggestions that the payment could amount to £10m (\$16.9m).



Trucks queued in the French port of Calais yesterday to cross to England by ferry instead of by train. Drivers faced additional problems from blockades by French truckers

saying that the sum involved would depend on the time for which services were suspended.

The Anglo-French intergovernmental commission, which will have the final say on the reopening of the tunnel is expected to meet on Friday. Eurotunnel said it was no longer giving forecasts of when it hoped to expand the number of services running through the tunnel but it said that Eurostar had been running empty trains through the tunnel to reposition them for the resumption of services.

Long-distance freight trains carrying containers and cars and car components have also been running through the tunnel.

Eurotunnel would be responsible for payments for the first three or four days of interruption of the service, after which UAP, the French insurance group, would be responsible for payments to compensate for the loss of operating income.

UAP will also pay for any civil damages and repairs to the tunnel, and the US company Chubb for the costs of replacing rolling stock.

Both Eurotunnel and Eurostar yesterday played down any suggestion of conflict or the prospect of litigation between the two companies in the search for compensation.

SNCF, the French state railway operator, said it was examining ways to "assure the protection of our interests".

But it stressed that its priority was for a resumption of the rail service as soon as possible after safety for passengers could be assured. It said it had no indication yesterday of when even a partial service would resume.

\$34m sale of Scottish dockyard agreed

Financial Times Reporters in London and Edinburgh

Babcock International, the engineering group, has agreed to buy the Rosyth Royal Dockyard in Scotland for between £20m (\$33.8m) and £25m after securing an order book worth an estimated £1bn from the UK Ministry of Defence.

The company, which has been negotiating the deal with the ministry for more than two years, yesterday said it had secured an order book worth an estimated £1bn from the UK Ministry of Defence.

The company, which has been negotiating the deal with the ministry for more than two years, yesterday said it had secured an order book worth an estimated £1bn from the UK Ministry of Defence.

The purchase price, while not officially disclosed by the ministry or Babcock, was said by some analysts to be about 30 per cent below original estimates.

"It's an excellent deal for Babcock. Rosyth is the best thing about the company at the moment," said Ms Janet Sidaway at Kleinwort Benson Securities.

Mr John Parker, Babcock chairman, said: "We believe we have achieved a good deal both for us and the Ministry of Defence."

He was speaking after Mr Michael Portillo, the defence secretary, predicted that privatisation of the yard would save the government more

than £100m over 10 years. Mr Portillo, announcing the sale at a meeting of Scottish MPs at Westminster, added: "It will also give Babcock the prospect of achieving a secure long-term future for the dockyard."

"To assist it in that, the government has allocated a significant programme of ship refit work."

But he rejected a plea from Ms Rachel Squire - Labour MP for Dumfries West, which includes Rosyth - to guarantee the value of the refit work already allocated to the yard. Babcock would have to submit competitive prices, he said.

Shares in Babcock have rebounded recently from a 12-month low of 44p on expectations of the Rosyth deal. They rose 2p to 46p yesterday.

Mr Portillo, meanwhile, told Scottish MPs that negotiations would be concluded shortly on the sale of the adjoining Rosyth naval base to Rosyth 2000, a consortium including Babcock, Scottish Power, Bank of Scotland and Forth Ports. Similar talks are expected to be completed before the end of the year with DML, the joint venture company bidding for Devonport Dockyard in south-west England.

Crest to keep to original schedule

By John Gapper, Banking Editor

Crest, the electronic share settlement system, intends to keep to its original timetable of being fully operational by the spring of 1997 despite the problems that have afflicted it in the past month, it was announced yesterday.

The board of CrestCo, the company that owns and runs Crest, decided against a delay in transition to Crest from Talisman, the paper-based share settlement system, after receiving clearance from regulators for the time being.

But the Securities and Investments Board, as well as other regulators, will watch how well Crest recovers from problems of reliability and slowness caused by software hitches, and its users' unfamiliarity with the system.

"The SIB emphasised that it would continue to monitor the situation closely". The SIB has used a consultant to examine Crest's problems independently of CrestCo, and it said there was no need to delay transition "at this stage".

CrestCo's 15-person board cleared the transition timetable after being told by Mr Iain Saville, CrestCo chief executive, that the performance of Crest had improved considerably in the past month due to software changes and the education of participants.

Mr Scott Dobbie, CrestCo's chairman, said board members had asked "detailed questions about the facts" during the meeting, but "the decision was reached almost by itself" after members saw data about improvements to Crest's speed.

The board has already decided to delay the transition of 17 large companies' shares into Crest, which will cut the strains on Crest during a six-week period starting on December 2. This break is to be used to catch up with backlogs.

UK NEWS DIGEST

Hollywood may cut investments

Hollywood studios may be tempted to reduce their investments in film production in the UK because of the recent weakening of the dollar against the pound, says a report from the British Screen Advisory Council, a body representing the film and television industries.

A big increase in the number of Hollywood-funded films made in Britain - including *Extraterrestrial*, starring Madonna, and Walt Disney's live action version of *101 Dalmatians* - has been a prime catalyst for the recent renaissance of UK film production.

One of the UK's chief attractions has been its comparatively low cost. But the council warns that sterling's recent rise has eroded this advantage. In August, the UK was cheaper than the US in five of the seven key elements of a film's production costs, according to the report, compiled for the BSAC by Hydra Associates, a management consultancy. However, the dollar-pound exchange rate has since risen from \$1.65 to around \$1.68; and the report estimates that the UK is now less expensive than the US in only two categories, executive salaries and fees for extras.

NATIONAL LOTTERY

Elton John may seek film grant



Elton John, one of the UK's most successful pop singers, is considering plans to bid for part of the Arts Council's £150m (\$270m) National Lottery film funding package for Rocket Pictures, his film production company. Rocket Pictures, which takes its name from Rocket Records, the singer's record label, was launched this month with financial backing from Walt Disney, the US entertainment group, to produce feature films and television programmes using British talent.

Earlier this month the Arts Council, which allocates state funding for the arts, invited bids for four private sector film franchises, each of which would be entitled to receive up to £25m of lottery funds over six years. Almost all the established UK film production companies have since become embroiled in negotiations to form consortia to bid for the franchises.

EQUITIES

Funds increase cash holdings

The UK's largest pension funds sold approximately £7bn (\$11.8bn) of equities over the past nine months and increased their cash holdings by approximately £5.6bn despite the relatively strong UK stock market.

A survey by the Wm Company, the Edinburgh-based investment management information and administration specialist, states that "UK pension funds may be gearing their investment portfolios for a significant downturn of the equity market".

It surveyed UK pension funds with investments worth £208bn and found that between June and August they sold a net £2.2bn-worth of shares and increased their cash holdings by £1.5bn.

NORTHERN IRELAND

Ex-MP's daughter sought

A daughter of Ms Bernadette McAliskey, a Northern Ireland nationalist who was once a member of the House of Commons in London, is being sought by German authorities for questioning about a mortar bomb attack by the Irish Republican Army on a British army base in Germany in June.

It is understood that police in Germany want to question Ms Róisín McAliskey, aged 25, about the mortar bomb attack on the British military base at Osnabrück in June. "The German authorities are in touch with us regarding their inquiries into serious terrorist crimes in their jurisdiction," Northern Ireland police said yesterday. The German federal prosecutor said Ms McAliskey faced charges of attempted murder and possession of explosives. Her mother was independent nationalist MP for Mid Ulster from 1969 to 1974.

BANKING

Savers warned on non-UK banks

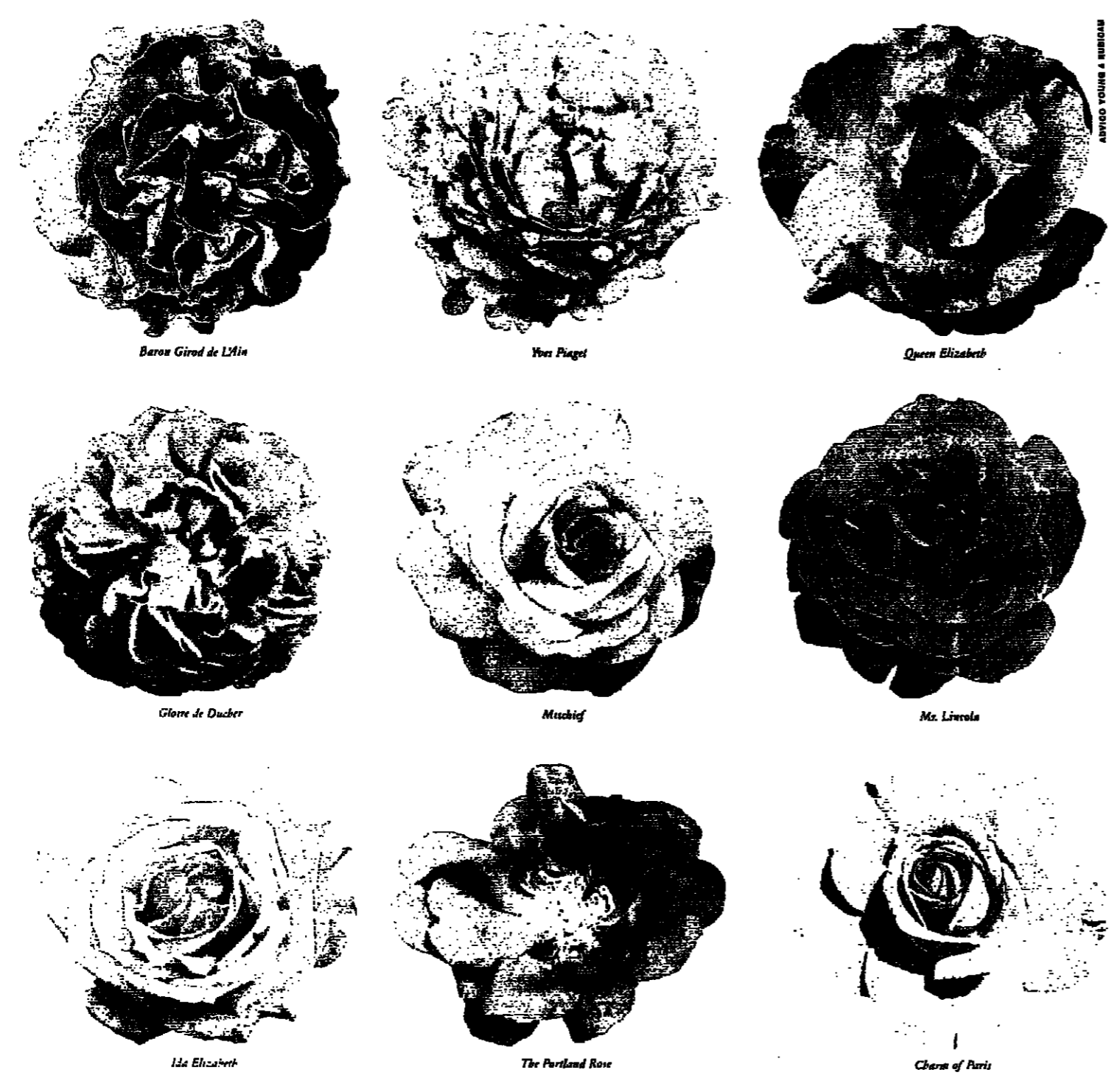
Savers in Britain need to take extra precautions before depositing money with banks or financial companies outside the UK, the Bank of England, the UK central bank, has warned.

Before answering advertisements on the Internet or elsewhere, the Bank says, depositors should check with local regulators whether the bank is authorised in its home country and what sort of deposit insurance is available, since deposits sent out of Britain will not be covered by the UK's protection scheme.

CORRECTION

Mr John Monks

Mr John Monks, general secretary of the Trades Union Congress, was misquoted in yesterday's edition. Mr Monks did not say union leaders found it increasingly difficult to win sympathy or understanding for their views from Mr Tony Blair, the Labour party leader.



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Farmers urge early cull of cows at risk from BSE

By Alison Maitland and Maggie Urry

The British government yesterday came under pressure from farmers' unions to hold a rapid cull of cattle most likely to develop bovine spongiform encephalopathy - even at the risk that it might not lead to a lifting of the European Union's ban on exports of British beef. The slaughter of about 147,000 cattle considered most at risk of developing BSE, or "mad cow disease", was agreed at the European Union summit in Florence, Italy, in June as a precondition for any easing of the worldwide ban.

"We made an agreement as a nation and we know Europe will not lift the ban unless we implement all of that agreement," said Sir David Nisbet, president of the National Farmers' Union of England and Wales, the biggest UK farmers' union.

Speaking at the Smithfield farming show in London, he joined counterparts from Scotland and Northern Ireland in arguing that a cull was the only chance of persuading EU states to ease the eight-month-old ban.

Mr Douglas Hogg, the UK agriculture minister, would not say whether the government would proceed with a cull, saying only that he expected a cabinet decision "soonish".

He agreed with the farming unions that a cull, opposed by many MPs in the summer, would now win parliamentary backing. But he questioned a selective slaughter, saying "EU member states have great difficulty in rapidly and substantially lifting the ban".

Mr Hogg tacitly acknowledged the slaughter policy had become entangled in electoral considerations, saying that in the run-up to an election "everything becomes a political football." He denied the cost of compensating farmers was a primary factor behind a government decision, but predicted reluctance to agree to heavy spending "which can't be justified".

Sir David admitted that his union had performed a U-turn over the cull, which it strongly opposed early in the year. "I'm not a bit ashamed of it," he said, arguing that most farmers now believed complying with export the Florence deal was the only way forward.

Asked what would happen if the cull was carried out and EU member states still refused to end the ban, Sir David said: "That's one of the risks we have got to take." The UK government said yesterday that 1m cattle had been slaughtered since May, which had posed one of the largest non-military logistical problems of recent years. The easing of the backing in the scheme coincides with better news on beef sales, with British supermarkets reporting that demand is picking up.

The UK government hopes by the end of the year to issue a consultation document on a national computerised database to identify and trace all cattle - another element of the Florence deal.

Onslaught begins on EU regulation

By David Wighton, Political Correspondent

The UK government will today launch an initiative to cut European red tape amid signs that other EU member states are becoming serious about deregulation.

Mr Roger Freeman, the minister in charge of deregulation, will use a meeting of the internal market council in Brussels to call for an extension of the EU's recently launched deregulation drive. He wants it to tackle areas ranging from testing of electrical equipment to renting out holiday cottages.

He said that Germany, Italy, Denmark, Finland, Austria and the Netherlands were all supporting the Single Market initiative, UK government officials said. France, which was initially cautious about the idea, was also enthusiastic.

Mr Freeman said the EU's initiative, launched by the European Commission in the summer, was already showing some successes and was attracting strong support from other member states.

"The mood has changed in Europe," he said in London yesterday. "There is growing recognition that the burden of regulation, particularly on small and medium-sized companies, is a serious disadvantage as far as jobs are concerned."

Today's meeting will con-

sider the first progress report from the SLIM project which has identified significant savings by simplifying export forms and construction product standards.

UK officials estimate that small UK firms could save £5m a year if the recommendations on simplifying Intrastat trade forms were adopted.

Mr Mario Monti, the single market commissioner, said: "The results of the first phase have been fruitful, confirm the validity of the method used and could well justify extending the project to other areas."

Mr Freeman will propose applying SLIM to the Electro-Magnetic Compatibility directive, which is designed to prevent electrical equipment interfering with pacemakers and other safety equipment. Singled out by the UK Federation of Small Businesses as one of the most burdensome regulations, it requires manufacturers to have one-off products, such as customised computers, sent to specialist test houses at significant expense.

Mr Jacques Santer, president of the European Commission, last night attacked scaremongering in Britain about the European single currency as "amazing." He used a speech in Dublin to deny suggestions that adopting the euro would make one government responsible for the debts of another.

When substance takes second place PM's Euro-opponents aim to obscure and not illuminate

The forces of opposition claim a triumph for democracy. Kenneth Clarke has to put aside his calculator to deliver an eye-of-Budget House of Commons statement on Europe's plans for single currency. John Major concedes a full debate on the issue before the Dublin summit of European Union leaders in 10 days. An important victory, you might say, for parliament over the executive, for transparency over secrecy. It is nothing of the sort.

One can hardly dispute that the government has been maladroit. What's new? Its insistence that scrutiny of the latest clutch of legal documents on economic and monetary union be handled by an obscure committee of MPs was always risky. But a tactical retreat two or three weeks ago would have passed unnoticed. As usual, Mr Major decided to dig in on the wrong issue.

On Europe the prime minister has a knack of confusing stubbornness with leadership. For more than two years he has allowed the sceptics to set his party's European agenda. Assessment carries a price. He can't expect to reclaim his authority now.

To mock Mr Major, though, is to miss the motives of his opponents. Tory sceptics and Labour alike, they have cloaked themselves in the high-minded rhetoric of democracy, of parliament's right to hold to account the government of the day. It is a sham. Neither party to this unholy alliance wants a cool debate about the legal



Kenneth Clarke: strongly pro-European chancellor

framework for a single currency, the subject of the documents now before the Commons. The aim is to frighten not enlighten, obscure not illuminate.

The sceptics see a chance to drive Mr Major further towards their ultimate goal of disengagement from Europe. Their first priority is to oblige the prime minister to fight the general election on a platform of preserving the pound. For his

play in negotiations among EU finance ministers. They add nothing to what is already known about the financial and fiscal framework.

Some profess to be startled by the notion that the proposed fiscal stability pact for Euro nations would involve fines on those nations running excessive budget deficits. Yet the provision has always been there in the Maastricht treaty (article 104c). So, too, has the requirement that all EU governments submit periodically to closer joint scrutiny of their economic performance (article 103).

Nor is there anything in the latest papers to support the charge that, outside Euro, Britain might still be subject to the rules of the single currency club. The only sanction the EU could use against a recalcitrant British administration would be to make public its criticisms. This is hardly a nuclear weapon. Mr Clarke's performance yesterday may not count as his most elegant yet. But his opponents failed to land a blow.

For the sceptics, this is not the point. Mr Major's government hangs by the slenderest of threads. They have a powerful lever over the prime minister. They see in Euro a fundamental threat to the sovereignty of parliament. That must take precedence over both the facts of the present controversy and over loyalty to the prime minister. The pro-European Mr Clarke is seen as the fundamental obstacle to their ambition of standing aside from a single currency. Anything that dam-

ages the chancellor can only further their objectives.

One imagines Labour is congratulating itself richly on all this. The Budget has been overshadowed and the divisions within the Conservative party reopened. Mr Major, conspicuously absent during Mr Clarke's statement, has suffered the indignity of a dressing-down from the officers of the 1829 Committee of Tory backbench MPs. Not bad for a week's work. And a fair objective, you might think, for a party fighting for power after 17 years in the wilderness.

I wonder, though, if Mr Blair has asked himself what price he will pay for such tactical manoeuvres if Labour wins the election. His party, after all, says it is enthusiastic about a single currency. Gordon Brown, the shadow chancellor, claims to be as committed a European as Mr Clarke. As far I can see, Mr Brown has no particular quarrel with the chancellor's present negotiating stance.

In office, Labour would learn pretty quickly that conducting a sensible debate is rather harder than scoring political points. Mr Blair boasts he would return Britain to the centre of European influence. To do so, he would need allies in other parties, not least Mr Clarke. We have reached the stage where a policy of sensible engagement in Europe will be possible only with a prime minister imaginative enough to mobilise the cross-party majority in favour of such a course.

Philip Stephens

Over 50s losing out to young workers

By Robert Taylor, Employment Editor

Employers prefer to recruit young people than anybody over the age of 50 who has taken early retirement, says a survey published yesterday by the Independent Institute for Employment Studies.

"Although some people welcome early retirement, many placed in this position still want or need to work," said Ms Sally Dench, the author of the report. "There seems to be an assumption as people reach a certain age they become less attached to work, have less to contribute and have less need to earn an income."

"This is frequently not the case; many older people are strongly attached to their work."

Mr Richard Worsley, director of the Carnegie Third Age Foundation, a pressure group championing the cause of older workers that commissioned the study, said: "The research shows how employers need to think carefully about the advice given to those leaving employment early."

The study covered a sample of 1,012 people who had taken early retirement since 1981 from seven large organisations, including three in the public sector. It presents a disturbing picture of what may be seen as a "wasted resource".

While 47 per cent said they had looked for another job, only half of them had found one that satisfied them.

Citizens First comes last

By Emma Tucker in Brussels

Fears of provoking another Eurosceptic outburst in Britain have prompted European Union officials in the UK virtually to blank out their own campaign to inform people about their rights in the single market.

So great is the sensitivity surrounding Britain's role in Europe that a simple information exercise, telling people practical things such as the fact that they no longer need to change their driver's licence when living in another EU country, is considered too controversial to air widely.

"This is Britain's new McCarthyism," commented one EU diplomat.

The campaign - known as Citizens First - is being given high-profile billing in virtually all other EU states with television and radio adverts as well as billboards informing people where to telephone for practical information.

These will be accompanied by widely available fact sheets on everything from how to look for jobs in other member states to guides on studying abroad.

Under single market legislation, EU citizens can work wherever they like in the Union. However, seeking work across frontiers is complicated, often because of the need to plug into local tax and social security regimes. The campaign, which lasts

two years and will cost £24m, (\$30.7m) is designed to help people overcome such difficulties.

The campaign is to be launched in Brussels today by Mr Mario Monti, the commissioner for the single market, followed by launches in all the member states. In Spain, the Spanish prime minister will attend while in the Republic of Ireland President Mary Robinson will appear.

But in Britain there will be one press conference in London. "We thought it was not worth running the risk of provoking an outburst of Euroscepticism by putting large adverts up so near to a general election," said a commission official.



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TECHNOLOGY

Is the universe ever-expanding, or will Big Bang - generally accepted as the way it all began - eventually be followed by a Big Crunch? None of us will be around to find out, but that is not stopping scientists from trying to answer the question. And some important clues may come from an unlikely location - a laboratory under 1,500m of solid rock.

At the Gran Sasso Underground Laboratory west of Rome, Germany's Max Planck Institute for Nuclear Physics is using the inherently low radiation background to determine if subatomic particles called neutrinos have mass. If they do, their density could be a piece of the puzzle in explaining dark matter.

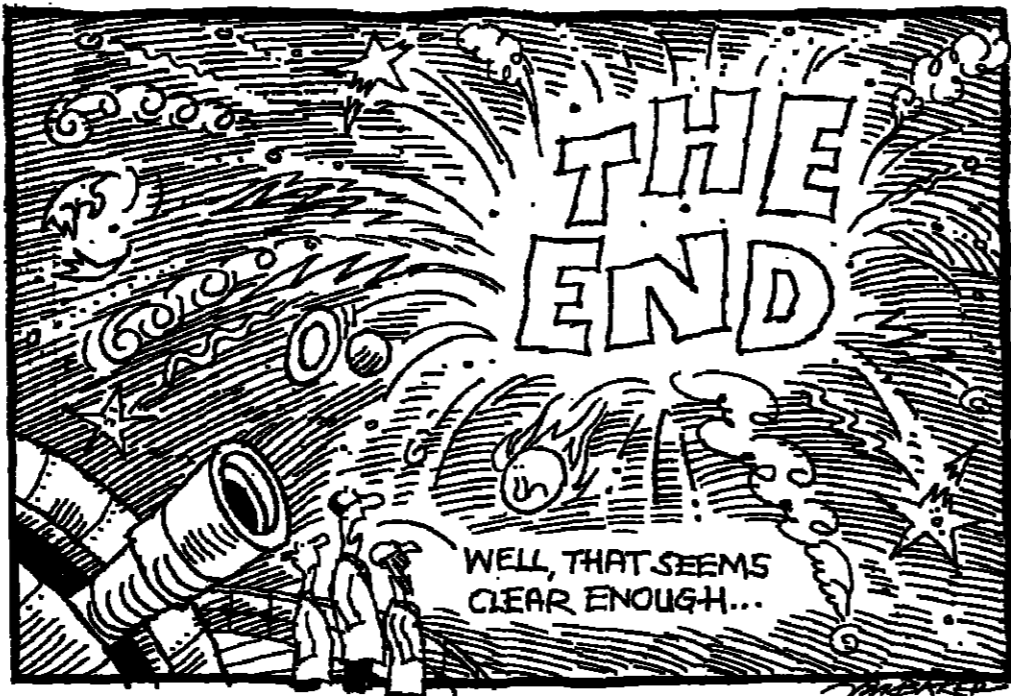
As the name suggests, dark matter is invisible to the naked eye, but its gravitational forces are evident from how galaxies rotate on their axes and orbit one another. Even after the Hubble Space Telescope's recent discoveries of more than 400 galaxies, estimates are that at least 90 per cent of matter in the universe is unseen.

"That is more than enough missing matter to determine whether the universe is ever-expanding or will eventually collapse. If the dark matter is sufficiently dense, scientists believe, the initial force from Big Bang will not be enough to prevent the universe from crushing down on itself.

Explanations for dark matter composition and existence include: baryonic (or ordinary) matter in the form of Machos (Massive Astrophysical Compact Halo Objects) which are Jupiter-sized planets, burnt-out stars and brown dwarf stars too small to ignite; Black Holes; and non-baryonic or subatomic matter, including particles such as Wimps (Weakly Interactive Massive Particles).

Wimps and black holes remain theoretical. But neutrinos have been proven to exist since the mid-1960s. And even though a neutrino might be a thousand times lighter than a single electron, their sheer numbers could account for a significant amount of non-baryonic dark matter.

"After the Big Bang when the first elements were formed, we know how much baryonic dark matter formed and can be in the universe," says Hans Klapdor-Kleingrothaus, the Gran Sasso experiment's director. "But we need more matter to understand the dynamics of galaxies and the inflation of the universe. There will never be enough baryonic dark matter to explain the behaviour of galaxy rotation. So we need something non-baryonic."



Dark mysteries

Scientists at an underground laboratory are seeking clues to the fate of the universe, says Bruce Dorminey

Neutrinos are the by-product of the normal radioactive decay that is possible in the nuclei of 35 different isotopes. The process involves a neutron degenerating into a proton which then emits an electron and a neutrino. Faster neutrino decay signals a larger mass. If the mass is large enough, the signal of its decay would be detectable above the experiment's very low background rates and the researchers could determine the neutrino's mass. The neutrinos themselves

are not seen, but their presence is measured by a process called Double Beta decay. At present the Heidelberg-Moscow experiment for its detection is the world's most sensitive.

"Now we can only say that the electron neutrino has a mass smaller than 0.5 (of an electron volt)," says Klapdor-Kleingrothaus. "How much smaller we don't know. By contrast, a single proton is 1836 electron volts. We're talking about something extraordinarily tiny. But because there are so many, even on that scale it would have an effect on gravity in the universe."

Meanwhile, a consortium of French researchers led by France's CNRS (National Centre for Scientific Research) has been searching for baryonic dark matter in a project called EROS (Experiment for the Research of Dark Objects). Begun two years ago using a 60cm telescope at the European Southern Observatory's La Silla installation in Chile, EROS observes stars in the Large Magellanic Cloud, a small satellite galaxy of the Milky Way.

The idea is that when a passing Macho crosses a star's line of sight it causes "gravitational lensing" for the earthbound observer - light bends around the Macho, creating an observable brightening of the more distant star. The French team has just begun EROS II, a year-long follow-up experiment which is also at La Silla and uses a 1m telescope. Future plans call for use of a 3.6m ESO telescope at the same site.

"After three years of observing brown dwarfs, we've detected mass that accounts for no more than 20 per cent of dark matter," says Marc Lachize-Rey, an EROS project collaborator and director of research at the CNRS's Saclay laboratory near Paris. EROS II, he says, will try to detect a wider range of mass and prove conclusively whether or not Machos account for only a small percentage of dark matter.

As for the Heidelberg-Moscow quest, it will continue for five to 10 more years. But even if neutrinos are proven to be dark matter they would at most make up only 30 per cent of the missing material. With Machos probably making up a further 20 per cent, that leaves researchers only halfway to solving the mysteries of dark matter, and still further from answering the big question about the fate of the universe.

Viewpoint · Ann Chambers

Break the barriers to Russian collaboration

The cold war created barriers which were detrimental to scientists in both the east and west. Even the best minds become sterile if they are isolated from fresh ideas and new techniques. A futile science and technology war was waged for more than 50 years, but now there are opportunities for knowledge exchange and joint research. In the interests of world science they should be wholeheartedly embraced.

There are also strategic considerations, as scientific developments affect economic progress. Western investment in Russian science would help generate economic growth. And by making firm commitments the west would ensure greater political and economic influence in Russia.

The plight of Russian science is now familiar to us. Federal government spending on science fell 80 per cent in real terms between 1991 and 1994. Top institutes have been forced to close and rare collections are being illegally traded by desperate scientists.

Individuals and because Russian and British scientific knowledge complement each other. Scientist Paul Yoxon expresses a similar view. His joint project in the Central Forest Area in Russia has led to a fruitful exchange of information on conservation techniques. Yoxon is particularly interested in biosphere reserves, a form of designated conservation area which was effective in Russia, but he also hopes to influence the Russian government's policy on conservation through passing on British experiences.

Bilateral collaboration is undoubtedly valuable to both sides, even on a small scale, for

It generates mutual trust and understanding. The London Initiative on the Russian Environment was set up to facilitate environmental assistance to Russia through the involvement of government, business, the academic community, non-governmental officials and research establishments. Although its activities have been limited because of a lack of funding on the Russian side, David Shreeve, one of the founders, is still encouraged by the thriving goodwill and interest gained from conferences and visits. Such initiatives are important as personal contact is the key to developing good relations.

However, the most substantial rewards are to be reaped from multilateral collaboration and this is where the west's future efforts must be directed. With expertise and resources pooled from more nations, the potential for progress is greatly enhanced. The European Union realised this and in 1993 set up an association to support scientific co-operation. The quality of research carried out under the

It is estimated that between 70,000 to 90,000 scientists emigrate from Russia every year

However, the handful of schemes in place is insufficient either to preserve Russia's precious resources or to woo its scientists back to research. Russian military specialists, particularly, have potentially dangerous knowledge and by collaborating with the west they can learn to redirect their skills and sell their know-how. The International Science and Technology Centre, established in 1992 by the Russian Federation, Japan, the US and EU, focuses on this area so scientists can, for example, apply knowledge of chemical weapons to biological fields. Scientific collaboration between Russia and the west will lead to progress in science and technology, economic growth and should also bring us closer politically. Most importantly, it offers the opportunity to get to know our neighbours. Once we get used to working together we will become indispensable to each other.

Ann Chambers is a freelance journalist, with a special interest in Russian affairs.

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Martin Wolf

A dream of a Budget

If the chancellor wants to avoid the mistakes of his predecessors, he should announce a tighter fiscal position and an independent Bank of England

Every commentator is a Walter Mitty. My fantasy is being Kenneth Clarke on Budget day. What would I say? Something like this.

"This Budget is likely to be my last, quite probably the last by a Conservative chancellor for some years.

"In framing it, I have remembered that in each of the last three decades the economy has overheated. On each occasion, a Conservative chancellor was in charge. On each occasion, the British people have paid the price in inflation, instability and unemployment.

"It is my duty to prevent this from happening now and to help ensure it will not happen again. For this reason, I am asking the following of my successors:

1. I am almost at the end of my powers to make the necessary changes to the way we do things.

2. Second, a further tightening of fiscal policy.

"Let me explain the background to these decisions.

"You expect me to boast about the world-beating performance of the British economy. I will disappoint you. True, we have introduced important reforms of the labour market, public ownership, pensions and control over public spending. The party opposite has been forced to accept almost all of these. Our continental European partners will, too.

"Yet the UK's performance has not been decisively superior to those of our neighbours: between 1986 and 1990, UK gross domestic product grew at the average rate of the European Union - 3.3 per cent a year. Between 1991 and 1995, it grew even more slowly than the EU average - 1.2 per cent as against 1.4 per cent.

"The recent growth must be set against the recession of the early 1980s. That was caused by the overheating of the late 1970s. This in turn, followed the embarrassingly vainglorious episode of the 'British miracle'.

"Those who refuse to learn from history are condemned to repeat it. Each time we promise ourselves to do better next time. Each time we fail.

"The story begins with excessive growth in money and credit, fuelled by tax cuts and soaring asset prices. This generates rapid growth in demand, which the short-term capacity of the economy fails to meet. The symptoms are unsustainably swift declines in unemployment, deterioration in the external balance and inflation.

"Expectations of higher interest rates and higher short-term real returns attract capital inflows, which drive up the exchange rate. This lowers inflation in the short term. When interest rates decline once again, so does the exchange rate, accommodating the higher prices appreciation had repressed.

"Rapid growth dramatically improves the fiscal position. In 1988 and 1989, the UK even had fiscal surpluses. Alas, these encouraged more tax cuts than proved sustainable. Tax cuts also increase the pressure on monetary policy. This reinforces the role of the exchange rate in lowering inflation, exacerbating the burden on industries subject to international competition.

"This is not ancient history. It is beginning to happen again now.

"Consider the recent picture: broad money growing faster than in any other member of the Group of Seven industrial countries; the largest monthly fall in unemployment since December 1994; house prices rising at an annual rate of over 7 per cent; and the volume of retail sales growing at 4 per cent a year. Meanwhile, the exchange rate is now back to DMZ54 - a 17 per cent appreciation from its trough in May 1996.

"My predecessors put too much faith in the continuation of the good tidings that come in early phases of rapid expansion. I intend to reduce the capacity of my successors to make the same mistake.

"The unified Budget, improved procedures for control over public spending, the inflation target, the Bank of England's inflation report and the publication of the minutes of my meetings with the Governor of



the Bank represent significant changes for the better.

"We must go further. So I now announce my first big set of proposals, which is for inclusion of the following reforms in our election manifesto:

• Independence for the Bank of England to achieve a target for inflation, laid down by parliament.

• Establishment of an independent commission to analyse our fiscal position, as suggested by Andrew Tyrie, erstwhile adviser to two of my predecessors.

"In neither case will ultimate responsibility be removed from democratically elected politicians. In both, the ability to exploit the gullibility of the electorate for short-term advantage will be curtailed.

"My second big decision is to push for a tighter fiscal position, this for two principal reasons. The first is to ease the burden placed on monetary policy and the exchange rate. The second is to create a demonstrably sustainable fiscal position, thereby improving long-term inflationary expectations, lowering long-term interest rates and enhancing the UK's capacity to stabilise the economy.

"The first of these aims is compelling. A chancellor who pours petrol on a blaze is a pyromaniac.

"On the second, it is vital to reduce the ratio of public debt to GDP after its doubling since the beginning of the decade. This means a public sector borrowing requirement of 2.5 per cent of GDP or, ideally, less over the cycle. But this year, despite five years of recovery and excellent tidings on the public sector borrowing requirement in October, the deficit will still be above that ratio. It could be above that level next year, too.

"The rate of return to sustainable deficits has been too slow. The debt ratio will fall significantly only if rapid growth continues for

Management - Richard Donkin

Executives on trial by benchmarking

LucasVarity has adopted a more sophisticated approach to select its senior team

Many companies formed by merger find themselves with a surplus of senior managers. LucasVarity, the motor components and aerospace group created by the £3.2bn (£6.4bn) June merger of Lucas Industries of the UK and Varty-Corporation of the US, was no different.

Like a growing number of companies, LucasVarity decided to take advantage of more sophisticated techniques to reassess the whole executive team. About 160 senior managers have been screened for the top 100 positions in the new company in a four-stage process using self-assessment, a battery of tests and an innovative new approach to benchmark their performance against the best in the world.

"I think it is only fair to be thorough in a process such as this because, after all, you are playing with people's lives," says Victor Rice, the chief executive who believes the method he has used has been less painful than many and scrupulously objective.

Rice used four methods to choose his team at LucasVarity. First, all the senior executives were asked to assess themselves. Second, they were subjected to a performance appraisal by their immediate bosses. Then they were all given a series of psychometric tests.

And finally, they were assessed using a programme developed by Egon Zehnder, the headhunting company, to benchmark the performance of executives against those who are recognised as the best in their sectors worldwide. The programme uses headhunting skills and resources to compare executives as they would when assessing the field in a recruitment assignment.

The more sophisticated company boss tends to see this as a good way of benchmarking the management team against the best people in similar businesses the world over," says John Grumbar, managing partner of Egon Zehnder.

He says the appraisals were developed in response to public service bodies in Latin America, Greece and Austria which were privatising services. These clients wanted the headhunters to gauge the effectiveness and quality of public sector staff moving into the private sector.

Since it was launched six years ago, the programme has been used on about 100 similar assignments covering 5,000 managers. Executives undergo intensive structured interviews with consultants who use the sessions to assess how well individuals display the qualities and abilities that are being sought. "What we are doing is measuring the human capital of the company," says Grumbar.

Executives are usually wary about the process, says Grumbar - particularly where they work for the target in a hostile takeover.

"The way it is presented to them is crucial," he says. "One of the key things for us is to set them at ease. We actually find that executives welcome the process when they see that the top management team is being assembled using an objective process run by a third party.

"They know we have no axe to grind so, in those circumstances, it's quite often the staff of the acquiring company who are most nervous."

The process, he says, not only weeds out people who are unsuited for the jobs they are doing, it also finds appropriate alternatives for their skills. Occasionally it will find that no one is of the calibre required for a certain position. In those cases the company must recruit from outside.

The method was also used by Wisconsin Central Transportation of the US after it bought four UK rail freight operators - Rail Express Systems, Mainline Freight, Loadhaul and Transrail Freight. These were combined into one company, English, Welsh, Scottish Railways, and Egon Zehnder appraisals used to choose the senior team from managing director down.

"In our case we had four people for every job," says Ed Burkhardt, president and chief executive of Wisconsin Central. "We needed to get a feel for their abilities, strengths and weaknesses so that we could make our decisions. These were people we did not know very well. The process involved a 360-degree look at every one of them and it was well received."

The result was that of 28 executives interviewed, four departed. Three American executives were brought in from the parent company and a finance director from outside.

"Without this approach we would have to make our own judgments without the benefit of all the information we were able to accumulate," says Burkhardt. "That would have been far more difficult to deal with."

One of the strongest advantages of the Egon Zehnder method, according to Rice, was that it provided an objective view of the capabilities of LucasVarity executives. "There were some areas where the analysis would assess the individual as inferior to what you would expect and there were other cases where it went the other way. There was the odd person who didn't like it or who froze during a psychometric test.

"But a big majority really believed it was genuinely impartial. At the end of the evaluations, there was no doubt that the whole process was full of integrity - and that's rare."

LETTERS TO THE EDITOR

Number One Southwark Bridge, London SE1 9HL.
We are keen to encourage letters from readers around the world. Letters may be faxed to +44 171-873 5938 (please see fax for details). E-mail letters.editor@ft.com. Published letters are also available on the FT web site, <http://www.ft.com>. Translation may be available for letters written in the main international languages.

Message to Kohl: Emu only at right price

From Mr Chris Allsopp and Mr David Vines.
Sir, Suddenly things have really changed in the Emu debate.

It now looks very likely that Germany will not meet the Maastricht criteria. As a consequence the panel of "Wise Men" (who in Germany have real authority) have recommended to Mr Helmut Kohl, the chancellor, that there is no alternative to delay in the establishment of monetary union.

But Mr Kohl wishes to rush on and to brush objections aside. The chancellor appears to have an implicit deal with France which he wants this to prevent "con-competitive devaluations" by those in the periphery who might well want to avoid joining the core Emu countries in recession.

If the French are successful in their objective, the overvalued currencies of the peripheral countries will be sitting ducks for speculative attack.

Is this the Europe of the future? It is fortunate that the run-up to Emu is happening at a time of recession; as a result the problems that Emu must face are already clear. They must be faced, now.

EU members (other than France and Germany) on which even a core-Emu will depend, should send a message to Mr Kohl. "You can have Emu; we are even in favour of it. But our price is this: no stability pact, and no ERM of the periphery."

Chris Allsopp, New College, David Vines, Balliol College, Oxford, UK

within Emu running "excessive budget deficits".

In return, France can have the kind of Emu which it wants: one with a requirement that those countries not in the first wave of the monetary union must join a new "ERM of the periphery" in order to be allowed to join Emu later.

The new price for the deal, now that Germany probably will not meet the Maastricht entry conditions, is likely to be a really watertight stability pact - to satisfy the Bundesbank.

Such an Emu would create a zone of despair and instability in Europe.

The proposed pact really will prevent national fiscal authorities from dealing with recession. Normally in a recession the "automatic stabilisers" allow tax revenues to fall, supporting

income and counteracting the downturn. It is no good pretending that "by the time Emu is working deficits will be under control and there will be room for such stabilisation". There will not. The stability pact will say: "Raise taxes as Europe goes into recession." And do not expect the European Central Bank to solve this problem - its priority will be price stability.

The ERM of the periphery will require second-wave Emu countries to stabilise their exchange rates against the euro for a trial period before they can join the monetary union. The French want this to prevent "con-

competitive devaluations" by those in the periphery who might well want to avoid joining the core Emu countries in recession.

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Chris Allsopp, New College, David Vines, Balliol College, Oxford, UK

Airbus claims the lead

From Mr Robert Alizart.
Sir, In his report ("Air France orders 20 long-haul jets as profits soar", November 21), David Owen reports Air France as saying that the B777 has the capability of flying non-stop further than the Airbus A340. The A340 is the world's longest range airliner, but none capable of flying its full complement of passengers and baggage non-stop some 7,300 nautical miles.

The B777 is also credited by Air France with having more business seats than the A340. This is not true for equivalent comfort standards. Seats in the A340 business class are in a six-abreast configuration, the arrangement prevalent in the business class sections of almost all airlines, while the B777 offers the less popular seven-abreast seating.

Robert Alizart, vice president, corporate communications, Airbus Industrie, 1 Rond Point Maurice Bellonte, 31707 Blagnac, Cedex France

Daunting outlook for European readers

From Dr Frederic Methlow.
Sir, I was delighted to read Michael Prowse's praise of the US ("A deep debt of gratitude", November 25). How hard it must be for him to return to Europe, where cynicism reigns and customer orientation is so hard to find. Only the UK might be able to bring back to him the sort of libertarian atmosphere of inner-city decay. But we all know that the UK is light years ahead of us in terms of economic policy. For those of us who do not believe in this fact, one trip with a recently privatised rail service will suffice.

And how much Mr Prowse must suffer if he is able to enter the consensus-driven

European mainland, where the debate about minimum working hours must represent the long-predicted nail in the coffin of European business. I appeal to the FT to keep Mr Prowse where he is (that is, Washington) and to fulfil his ultimate dream and pass over to him an assignment in the Midwest. We Europeans are simply too backward-looking to face the prospect of reading his contributions over the next couple of years. Please have mercy on a poor, narrow-minded reader of your newspaper.

Frederic Methlow, Kinseggstr 11, 8033 Zurich, Switzerland

From Mr Tony Bird.
Sir, I agree with most of what Michael Prowse says about the niceness and decency of Americans in his article "A deep debt of gratitude".

But he goes too far when he says: "Little more than a century after its founding, the US had... all but eliminated the horrible class and status distinctions which still disfigure European and Asian society."

Isn't he forgetting the distinction between white and black?

Tony Bird, 193 Richmond Road, Kingston upon Thames, Surrey KT2 5D, UK

Labour relations climates more relevant

From Mr Peter McKenna.
Sir, The 18m unemployed in the EU must feel their plight is far removed from the arcane arguments in Brussels over graphs "using synthetic indices of regulation, constructed from approximate and subjective ratings of five categories of employment legislation"

could be a factor. They might like to hear from EU officials on their explanation of this difference, what can be learned from it and what action they propose.

Peter McKenna, Tible Barn Cottage, Temple Lane, Bisham, Marlow, Bucks, UK

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FINANCIAL TIMES

Number One Southwark Bridge, London SE1 9HL. Tel: +44 171-873 3000 Telex: 922186 Fax: +44 171-407 5700 Tuesday November 26 1996

Channel tunnel safety

Are privatised infrastructure projects such as Eurotunnel less safe than ones run by the state? On the face of it, the question is absurd: few ventures are more inherently risky than flying, yet privately-owned airlines are just as safe as state-owned ones.

Road outrage

Mr David Shaw, MP for Dover, has come up with a way for dealing with the French lorry drivers' strike which has blocked roads round 30 cities and marooned 1,000 British truckers in their cabs.

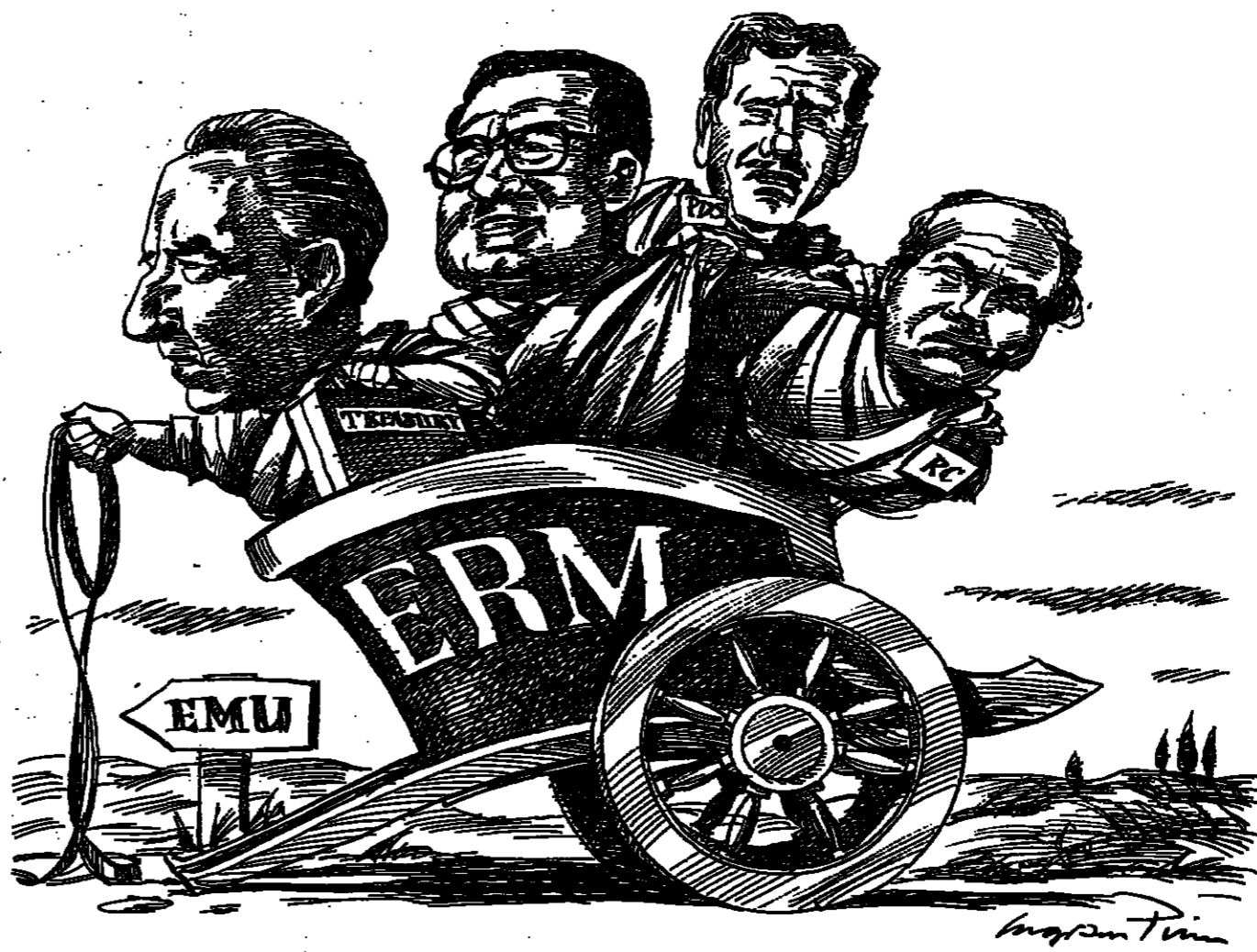
Votes overruled

While there is plenty of encouraging news about the consolidation of democracy in central and eastern Europe, recent developments in at least two countries are a depressing reminder that this trend is not a universal one.

The laurels must wait

Italy's centre-left coalition still faces difficult challenges despite the boost from the lira's return to the ERM, says Robert Graham

The return of the lira yesterday to the disciplines of the European Exchange Rate Mechanism marks a milestone in Italy's difficult but determined pursuit of international credibility.



Italy's trade union movement and the outcome of their negotiations will have a much broader effect. The unions are seeking to recoup a sizeable part of real earnings eroded by inflation since 1994.

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OBSERVER

Co-operate or else

The general atmosphere inside the Organisation for Economic Co-operation and Development, the industrialised world's most influential think-tank, will be ruffled today as disgruntled staff at its Paris headquarters protest over its attempt at "downsizing".

More madness

The European parliament's inquiry into mad-cow disease has trundled on for 10 weeks. Although for all the public interest it's received it might have been 10 years. A few sparks might

Spectacle case

Editorial choices speak volumes, as we all know. Thus we are tempted to regard Jürgen Schirring's decision to change his style of spectacles as something more than mere window dressing.

City climbdown

Pasquell Maragall's departure at the weekend as mayor of Barcelona means he will have more time to indulge his passion of philosophising about urban life.

Flightless birds

Some 250 American-grown stews will now probably not end up roasting on the plates of indigent families in the Caribbean at Christmas. They were to be donated by US farmers to the First Baptist Church in Florida, thence to be shipped out to the Caribbean.

100 years ago

The introduction of motor cars "The introduction of motor cars, opening up as it does an industry of enormous importance, affords the opportunity for the safe and profitable employment of capital scarcely second to that embraced in the great Railway System."

50 years ago

China Takes Action The difficulties that have long confronted the Chinese Government in the endeavour to put its house in order are well recognised in the City. Any information, therefore, which indicates progress is welcomed. Brief cables, however, seem to indicate that the Chinese authorities are at long last taking the steps necessary to restore some semblance of balance between exports and imports.

Financial Times

"In a free market, profit is society's reward for those who serve its interests."

FRUEHAUF TRAILERS Carrying the nation's goods

Leaders divided on importance of decision

Apec supports planned free trade deal on IT

By Edward Luce and Guy de Jonquieres in Manila

Pacific Rim leaders yesterday bowed to pressure from US president Bill Clinton by backing a planned free trade deal for information technology products...

The leaders' statement on IT was the climax of a summit of the 18-member Asia Pacific Economic Co-operation forum...

The leaders called for an IT agreement in the World Trade Organisation which "would substantially eliminate tariffs by the year 2000..."

Mr Clinton called the statement "a big deal", and a senior US official said support from the Apec leaders - whose economies generate more than half of world trade - obliged

WTO members to conclude a far-reaching accord at their ministerial meeting in Singapore next month.

However, Mr Goh Chok Tong, prime minister of Singapore, which will host the WTO meeting, said the forum's IT statement was ambiguous...

Dr Mahathir Mohamad, Malaysia's prime minister, said the 2000 deadline had no binding force.

Mr Qian Qichen, foreign minister of China, which is not a WTO member, said there was a case for cutting IT tariffs, but negotiating on the timetable or the products to be covered was not a task for Apec.

Even US officials seemed confused about what the leaders' statement meant. Some claimed it implied abolition of tariffs on all IT products...

Mr Clinton called the statement "a big deal", and a senior US official said support from the Apec leaders - whose economies generate more than half of world trade - obliged

hailed the summit as a step towards closer Pacific Rim relations, some expressed disappointment at its results.

Dr Koo Chen-Fu, a senior Taiwanese official who represented the island at the summit, regretted that more had not been done to turn Apec's free trade vision into reality.

Mr Qian said the leaders needed to focus more on technology transfer and economic co-operation. He criticised Apec's industrialised members for seeking free trade in IT while still protecting their textiles markets.

He also expected negotiations on China's bid to join the WTO to resume in earnest in the first half of next year. This is the closest Beijing has come in public to confirming that it plans to submit an improved negotiating offer.

Mr Clinton told Chinese president Jiang Zemin on Sunday that the US would be "flexible and pragmatic" in the negotiations, provided Beijing pledged to open its market further and embrace WTO rules.

UK urges France to seek end to truck blockade

By David Buchanan in Paris

French truck drivers tightened their blockade of main roads and petrol depots yesterday, leading to localised fuel rationing for the first time in their week-long protest.

The dispute is causing increasing disruption of international freight. About 200 UK truck drivers were stranded at Calais, five crossing points on the Franco-German border near Strasbourg were blocked and a main road from Lille to Belgium cut.

Sir George Young, the British transport minister, urged his French counterpart to bring the dispute to an end as soon as possible.

Britain's Road Haulage Association said more than 700 British vehicles were estimated to have been caught up in the blockade.

Mr Alain Juppé, the French prime minister, said his government was "doing everything" to facilitate the complex negotiations between representatives of the country's 35,000 road haulage companies and their employees. After 14 hours of fruitless negotiations that ended early yesterday, the government-appointed mediator called another session last night.

Mr Jacques Barrot, the labour minister, called on employers to "make an effort", suggesting the government might provide aid to help them let older drivers retire early.

The truckers are demanding a reduction in their retirement age from the national norm of 60 to 55, as well as higher wages and pay for time spent waiting between loads.

At the start of last night's session, the drivers' employers rejected as "unacceptable" what they said were union demands for "a 33-30 per cent rise in salaries and payment for all hours, including rest hours".

Directing their irritation more at the haulage companies last night, government officials said employers seemed less ready for a deal than the drivers. Officials even suggested that larger companies saw an interest in continuing the conflict to shake-out weaker competitors.

The dispute is the most serious since the national rail strike a year ago. Yesterday five rail unions instructed their members to show support for the drivers "in whatever way they judge useful". Despite the prospect of the protest widening, the government has made clear it has no intention at this stage of using police or the army to clear the blockades which, technically, are illegal.

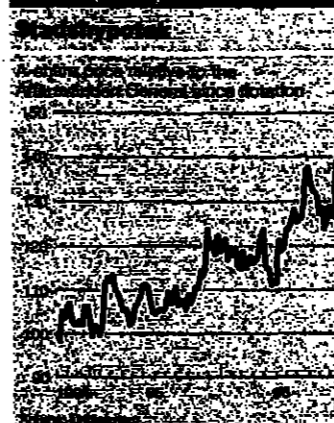
Editorial Comment, Page 17

THE LEX COLUMN

Striking attitudes

The latest round of strikes in France will inevitably spark worries that the country is in for a rerun of last year's wave of discontent. Yet, at present at least, the comparison looks misleading.

FTSE Eurotrack 200: 1902.4 (+16.7)



deliver a cosmetic boost to earnings per share, the benefit would be entirely offset by the reduced quality of the earnings stream, and the resulting lower rating for the shares. With no apparent tax benefit, investors would have gained nothing.

Moreover, a buyback from the government would have to be subject to hawk-like scrutiny from KLM's other shareholders; there is an obvious risk that the government could be favoured by an artificially high buyback price. The only fair solution would be to offer the buyback to all shareholders at the same price. Yet that way, KLM would have to gear up further still. It would be far better to avoid the buyback idea altogether.

holders, and there are interested bidders out there.

By contrast, Skandia's primary interest appears to be gaining access to Stadsbyttek's surplus capital to shore up its own stretched balance sheet. Given the weak industrial logic, it is unlikely to be able to pay top front.

That said, Skandia has offered a decent premium to Stadsbyttek's book value. Having opposed this merger, the government needs to show that it can secure a better offer for all shareholders. Simply selling its own stake to the highest bidder while leaving other investors high and dry would be an unacceptable alternative. And it would send out a powerful warning against future Swedish privatisations.

UK/Emu

While Britain's members of parliament were working themselves into a tizzy over the regulations for a single European currency, financial markets emitted one big yawn. In theory, a single currency could exert discipline on how the UK frames its fiscal policy, but Britain would first have to join the euro. With both main political parties hopelessly divided on the issue, it is hardly surprising that financial markets are not taking the possibility very seriously at present.

Mr Kenneth Clarke, the chancellor, rightly points out that Britain still has an interest in the details of the so-called stability pact, which is supposed to stop budget deficits inside the single currency area ballooning. After all, the UK might at some point choose to join the euro. Still, from a financial rather than a political perspective, the precise form of the pact is of secondary importance.

True, a rigid approach that severely penalised countries with excessive deficits might provide somewhat more discipline than a loose pact with limited fines. But it is worth remembering that the main discipline to be virtuous will come from financial markets rather than bureaucrats - provided, that is, Brussels does not give the impression it will bail out the prodigal. And this discipline will apply to Britain, whatever it decides about the euro. Mr Clarke has an excellent opportunity to show he has learnt this lesson when he presents his Budget this afternoon.

Additional Lex comment on Christian Salvesen, Page 25

Russians control telecoms

Continued from Page 1

holding company for the government's stakes in 85 regional telecoms operators, was first intended for sale as a separate entity, and Stet of Italy last December came close to taking a 25 per cent stake.

But the climate for substantial western investment and competition in strategic Russian industries has worsened since the election as President Yeltsin's backers such as Most, Alfa Bank, Stalichny Bank and Menatep have increased their political influence.

Scandinavian merger doubt

Continued from Page 1

against analysts' estimates of net worth of around SKr2.1bn. Skandia said Stadsbyttek's surplus capital, estimated at SKr4.4bn-SKr5.5bn, would help fund its expansion in savings-linked activities. It said the merged group would reap cost and synergy benefits of SKr2bn by 2000.

Skandia made operating profits of SKr541m in 1995, against a SKr187m loss the year before. Stadsbyttek's profits were SKr3.1bn, versus SKr1.7bn.

Marketing of World Cup hit by resignations

By Jimmy Burns

Three senior executives have resigned in protest from ISL, one of the world's leading sports marketing companies.

Their departure threatens to plunge the handling of World Cup football contracts into fresh turmoil.

Mr Peter Sprogis, Mr Steve Dickson, and Mr Tom Hipkins quit over the corporate restructuring plan recently announced to staff by Mr Jean Marie Weber, the Lucerne-based company group chairman.

The executives were key figures in the company's successful SFr2.8bn (\$2.3bn) joint bid, together with the German media group Kirch, for television rights outside the US to the 2002 and 2006 World Cups. Their resignations come as Fifa, world football's governing body and ISL's leading client, is preparing to invite tenders for key marketing contracts covering the two World Cups.

Mr Weber has created a holding company called ISMM Investments and a group management board, with himself as president and including three other ISL senior executives.

management structure, although they had been offered continuing senior roles in ISL's TV, football, and legal departments.

ISL has several existing contracts including the marketing rights to the 1998 World Cup in France and the track and field World Championship in Athens next year.

Mr Christopher Majms, ISMM's chairman, said last night: "Our company has experienced a very strong growth pattern over the last year that requires an adjustment in the management structure to integrate all our businesses."

Sports industry executives suggested last night that the resignations could undermine the confidence in which the company is held by sports organisations.

The three were unavailable for comment yesterday. But an internal senior staff memorandum said the move follows "major philosophical differences" over the management and future direction of the company.

ISL recently added to its existing marketing operations in Europe, Asia, and the US, by opening offices in Amsterdam and Brussels.

Fifa said last night it was aware of the resignations but would not comment further.

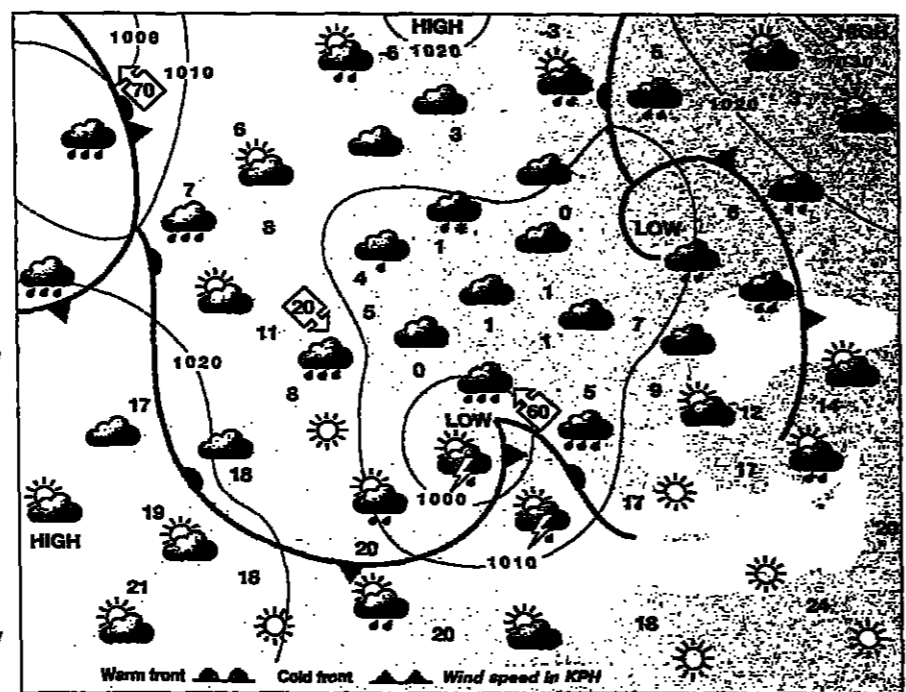
FT WEATHER GUIDE

Europe today

High pressure will promote dry conditions with a few sunny spells over most of the UK. Cloud will thicken in Ireland and rain will start in the afternoon. The Benelux and France will be cloudy. Northern Germany will have patchy rain and sleet. Spain and Portugal will be mainly dry but the north will be drizzly. An active low will cause numerous thunder showers in Italy. The seas surrounding Italy will be very windy. A low over Belarus will cause cloud and showers in Ukraine and parts of Russia with temperatures a few degrees above freezing. The south-eastern Mediterranean will stay mainly dry and mild.

Five-day forecast

The UK will stay unsettled. The Mediterranean and Balkans will remain windy and wet. The rain will gradually spread towards Turkey. Southern Scandinavia will turn frosty. Central Europe will be cloudy with local rain or sleet and snow above 500m.



TODAY'S TEMPERATURES

Table listing temperatures for various cities including Abu Dhabi, Accra, Algiers, Amsterdam, Athens, Atlanta, B. Aires, Bham, Bangkok, Barcelona, Beijing, Belfast, Belgrade, Bern, Bogota, Bombay, Brussels, Bucharest, Cairo, Cape Town, Caracas, Cardiff, Casablanca, Chicago, Cologne, Dakar, Dallas, Delhi, Dhaka, Dublin, Dushanbe, Edinburgh, Frankfurt, Geneva, Glasgow, Hamburg, Helsinki, Hong Kong, Hanoi, Istanbul, Jakarta, Jersey, Karachi, Kuwait, Las Palmas, Lima, Lisbon, London, Luxembourg, Lyon, Madeira, Madrid, Manila, Mexico City, Milan, Montreal, Moscow, Murcia, Nairobi, Naples, Nassau, New York, Nice, Niassa, Oslo, Otago, Paris, Perth, Prague, Rangoon, Reykjavik, Rio, Rome, Sao Paulo, Seoul, Singapore, Stockholm, Strasbourg, Sydney, Taipei, Tangier, Tel Aviv, Tokyo, Toronto, Vancouver, Venice, Vienna, Warsaw, Washington, Wellington, Zurich, Abu Dhabi, Accra, Algiers, Amsterdam, Athens, Atlanta, B. Aires, Bham, Bangkok, Barcelona, Beijing, Belfast, Belgrade, Bern, Bogota, Bombay, Brussels, Bucharest, Cairo, Cape Town, Caracas, Cardiff, Casablanca, Chicago, Cologne, Dakar, Dallas, Delhi, Dhaka, Dublin, Dushanbe, Edinburgh, Frankfurt, Geneva, Glasgow, Hamburg, Helsinki, Hong Kong, Hanoi, Istanbul, Jakarta, Jersey, Karachi, Kuwait, Las Palmas, Lima, Lisbon, London, Luxembourg, Lyon, Madeira, Madrid, Manila, Mexico City, Milan, Montreal, Moscow, Murcia, Nairobi, Naples, Nassau, New York, Nice, Niassa, Oslo, Otago, Paris, Perth, Prague, Rangoon, Reykjavik, Rio, Rome, Sao Paulo, Seoul, Singapore, Stockholm, Strasbourg, Sydney, Taipei, Tangier, Tel Aviv, Tokyo, Toronto, Vancouver, Venice, Vienna, Warsaw, Washington, Wellington, Zurich.

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Advertisement for RAO Gazprom featuring a world map, company logo, and share information: 27,255,000 American Depositary Shares, 272,550,000 Ordinary Shares, Price U.S. \$15.75 an ADS. Includes names of financial advisors like Morgan Stanley & Co., Dresdner Kleinwort Benson, CS First Boston, Natwest Securities Limited, and Salomon Brothers International Limited.

Handwritten signature or mark at the bottom of the page.

COMPANIES AND FINANCE: INTERNATIONAL

Absa ahead of expectations with R595m

By Mark Ashurst in Johannesburg
Absa has struggled to integrate its four constituent banks, but analysts said the results were above expectations.

Absa has struggled to integrate its four constituent banks, but analysts said the results were above expectations.

have set a target of 60 per cent for 2000, the peer group average for the period was 65.8 per cent.

conservatively, in line with Absa's goal of developing a more balanced portfolio.

conservatively, in line with Absa's goal of developing a more balanced portfolio.

Skandia pre-empts banking sector shake-out

The planned mega-merger between Skandia, Sweden's largest insurer, and Statshypotek, the country's biggest mortgage bank, marks the opening gambit of the much-heralded restructuring of Sweden's financial sector.

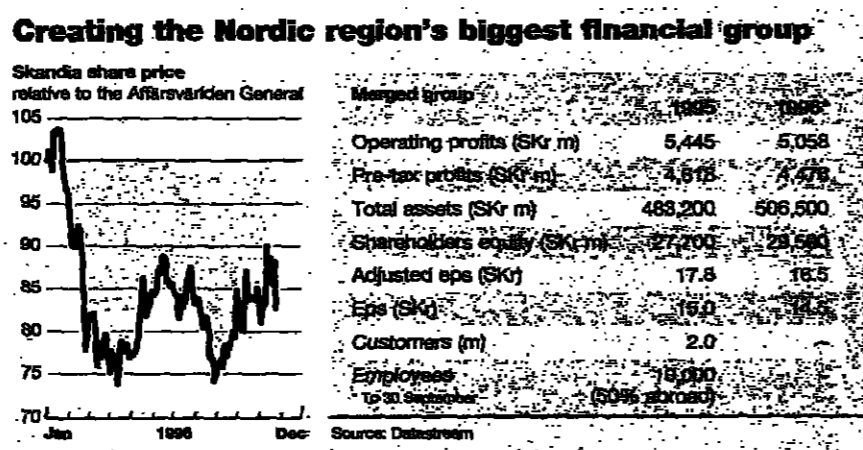
Financial deregulation, sluggish domestic growth and looming European monetary union have united to form a strong impetus for consolidation in the industry as leading groups compete to protect and enhance their market shares.

Much of the speculation has centred on Statshypotek, with its dominant 30 per cent share of the mortgage lending market.

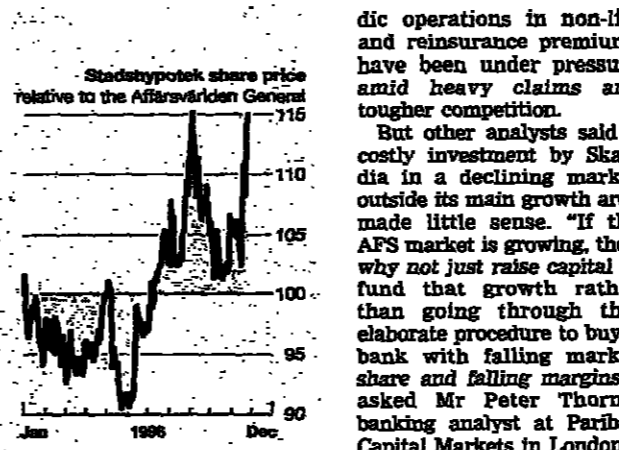
Nevertheless, the tie-up between Skandia and Statshypotek would create the largest financial services group in the Nordic region, with total assets of SKr500bn (\$76.6bn) and a market capitalisation of around SKr45bn.

Executives of both companies were at pains in Stockholm yesterday to highlight the merger's merits, saying it would enhance shareholder value next year and yield synergy and cost benefits totalling SKr2bn in 1997-99.

Where this leaves the deal is hard to say, Skandia would not be drawn on how it would act were it to be rebuffed by the government, although it said its aim was 90 per cent acceptance.



Skandia share price relative to the Affarsvärlden General



Statshypotek share price relative to the Affarsvärlden General

Table with 2 columns: 1995, 1996. Rows include Operating profits (SKr m), Pre-tax profits (SKr m), Total assets (SKr m), Shareholders equity (SKr m), Adjusted eps (SKr), Eps (SKr), Customers (m), Employees (to 30 September 1996).

Source: Datastream

INTERNATIONAL NEWS DIGEST

Thomson-CSF set to axe 5,000 jobs

Thomson-CSF, the defence arm of France's state-controlled Thomson electronics group, expects to trim its domestic staff to 32,000 full-time equivalents by the end of next year - a reduction of 5,000, or 15.5 per cent, from end-1995 levels.

Telefonica eyes Latin America
Telefonica, the Spanish telecoms group, plans to create a new operator in Latin America to offer data transmission and value-added services to channel international traffic to its area operators.

ActivCard heads for Easdaq
The race to list on Easdaq, Europe's new stock exchange for high-growth technology stocks, accelerated yesterday as ActivCard, a French developer of smart cards that make identity checks on users of personal computers, announced it was planning to raise up to \$30m in the new market.

Valero upbeat on dividends
Valero, the French automotive supplier, expects to make a more generous dividend payout for the 1996 financial year and thereafter. In an interview with the French La Tribune newspaper, Mr Noel Goutard, chairman, said that until now the company had been restricted in its dividend payments by the need to pay off debts.

Winterthur sees 20% advance
Mr Peter Spaelti, chairman of Swiss-based Winterthur Insurance Group, said the company's full-year net profit could rise nearly 20 per cent. In an interview with the Finanz und Wirtschaft newspaper, Mr Spaelti said net profit had grown an average of 19.6 per cent from 1993 to 1995.

Israel Discount Bank ahead
Israel Discount Bank, Israel's third-largest bank, yesterday announced an 11 per cent rise in net income for the first nine months of the year but made larger provisions for bad debts, especially in the building sector.

Israel Chemicals sharply up
Israel Chemicals, the fertilizer and chemicals group, reported a sharp rise in profits for the first nine months of the year fuelled by exports and despite the high value of the shekel against the dollar.

Pripps Ringnes reveals hitch in Coca-Cola talks

Nordic drinks group Pripps Ringnes said yesterday that negotiations with Coca-Cola of the US over the winding-up of a production and distribution alliance in Sweden and Norway had hit difficulties, but talks were continuing.

"We are still in negotiations. It might be difficult to reach the terms we came to in June," Pripps Ringnes said.

Last year Coca-Cola cancelled a 43-year-old licensing deal with Pripps Ringnes, a joint venture by the Swedish vehicle maker Volvo and Norwegian conglomerate Orkla.

The reason for the falling-out was not known but some observers suggested Coca-Cola was unhappy with its Swedish sales.

In June this year the two companies produced a letter of intent concerning the winding-up of their co-operation in Norway and Sweden.

"The parties subsequently agreed to extend co-operation on sales and distribution in Norway until May 1, 1997. It now appears clear that the parties will not reach agreement on finalising the negotiations on the basis of the letter of intent."

"However, negotiations on adequate agreements concerning the winding up of cooperation in Norway and Sweden are continuing."

Coca-Cola has been in talks with Denmark's Carlsberg over future production and marketing in Sweden and Norway. Carlsberg has such an agreement with Coca-Cola in Denmark.

Pripps Ringnes said that if it was impossible to reach agreement over winding-up arrangements, co-operation between the parties would be based on the agreements that existed before June's letter of intent was entered into.

This meant that in Sweden, the contract would end on April 1 1997 and from that date Coca-Cola would take responsibility for its own production and distribution.

"Pripps has previously stated that the company disputes Coca-Cola's legal right to cancel the agreement in Sweden, and Pripps will as a consequence of a cancellation bring a claim for compensation against Coca-Cola," the company said.

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NOTICE OF INVITATION TO TENDER. The North of Scotland Water Authority is announcing its intention to put to tender under a restricted procedure, the supply and maintenance of its fleet of commercial vehicles and on-road plant.

GLOBAL EMERGING MARKETS INVESTMENT COMPANY. Notice to Holders of MEDICAL CARE INTERNATIONAL, INC. 6 1/2% Convertible Subordinated Debentures Due 2006.

COMPANIES AND FINANCE: EUROPE

US groups reach deal in Slovak GSM dispute

By Vincent Boland in Prague

Two US telecommunications groups have reached agreement with Slovakia's state-owned telephone company on ownership of a new digital mobile telephone network, ending a dispute that has its origins in the break-up of Czechoslovakia nearly four years ago.

US West said yesterday that it and Bell Atlantic had each agreed to take a 20 per cent stake in EuroTel Bratislava, recently awarded a licence to operate the global standard for mobile telephony (GSM) system, one of two the government granted this year. Slovenské Telekomunikácie (Slovak Telecom), the state operator, will hold 80 per cent.

The dispute arose after the government said that Slovak shareholders must own 60 per cent of any consortium granted a GSM licence.

US West and Bell Atlantic own 48 per cent of another

joint venture with Slovak Telecom operating an analogue mobile system. They believed they were entitled under that contract, dating from 1991 and covering operations throughout former Czechoslovakia, to the GSM licence under the same terms.

The current Slovak government, however, insisted on setting its own terms, including new ownership rules, when it unveiled plans in January to grant two

GSM licences. This was consistent with the government's policy of favouring domestic investors when awarding contracts.

EuroTel was awarded the GSM licence in September and given 90 days to meet the ownership rules. At one point the telecoms ministry warned the consortium would lose the licence if it failed to agree with the terms. A settlement was reached after several weeks of negotiations between the

two companies and Slovak Telecom.

US West said yesterday EuroTel would now "fulfil all requirements of the GSM licence" and promised to offer services in the three main Slovak cities by March. It has selected Ericsson, the Swedish telecoms group, to supply equipment.

The dispute at EuroTel has given Slovtel, which won the second GSM licence, a head-start in launching its new service throughout Slo-

vakia. France Télécom owns 35 per cent of that joint venture. Its partners are Slovakia's state-owned electricity and gas utilities, three energy distribution companies and a privately-owned local investor.

Each GSM licence cost \$8m, and both networks will require substantial investment. Each partner in EuroTel is likely to contribute to the cost of the investment according to its stake in the joint venture.

EUROPEAN NEWS DIGEST

SAI officials quit after court case

Mr Salvatore Ligresti, chairman of Societa Assicuratrice Industriale, the Italian insurance group, has resigned, said Mr Luciano Roasio, director-general. Mr Roasio also announced the resignation of Mr Fausto Rapisarda, managing director. SAI presented Mr Ligresti and Mr Rapisarda's resignations to Isvap, the insurance industry control body, which had asked the two officials to resign after the appeals court's sentence in a case concerning bribes paid to gain insurance contracts from Ente Nazionale Idrocarburi.

AFP News, Milan

Crédit Lyonnais head upbeat

Crédit Lyonnais, the French bank, hopes for a break-even result in 1996 after the inclusion in this year's accounts of provisions covering all restructuring plans until 1998.

Mr Jean Peyrelevede, chairman, said in a radio interview: "Crédit Lyonnais is doing much better." Crédit Lyonnais' international corporate banking division had a net return on equity of 15 to 20 per cent, a level comparable to that achieved by the best UK and US banks, he said. However, the profitability of its domestic and European retail banking division was close to zero.

Mr Peyrelevede said the bank was "already rescued", but added that the next round of talks with the EU on the privatisation of the bank would determine "once and for all Crédit Lyonnais' future".

AFP News, Paris

Aerospatiale bullish

Aerospatiale, the French aircraft manufacturer, was likely to achieve full-year net profit of twice the FF273m (\$53.6m) profit made in the six months to June, Mr François Augue, finance director, said in an interview in the German newspaper Handelsblatt. The company expected profit of about FF2bn for the next two years, he added. Mr Augue said the forecasts take account of cuts in defence budgets, but have not integrated all the positive effects of Airbus Industrie's strong order book.

AFP News, Frankfurt

French retailer to lift exports

Pinault-Printemps-Redoute, the French retailer, planned to increase its foreign sales to 40 per cent of its turnover by 2000, Mr Serge Weinberg, chairman, said in an interview with French daily Le Figaro. "Last year, the Pinault-Printemps-Redoute group made 28 per cent of its sales outside France, which is too little." He also said the company did not plan any further significant divestments.

"We will continue the rationalisation of marginal activities, but there is no major sale planned," Mr Weinberg said.

AFP News, Paris

CS Holding appointment

CS Holding, the Swiss banking group, has filled the last gap in its new top management team with the appointment of Mr Walter Knabenhans as chief risk officer. Mr Knabenhans was chief operating officer of Credit Suisse Financial Products. Management at CS Holding, which is changing its name to Credit Suisse Group, has been in flux since the group announced a restructuring in July.

William Hall, Zurich

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Carlsberg above expectations

By Hilary Barnes in Copenhagen

Carlsberg Brewery Group increased pre-tax profits 10.5 per cent from DKr1.42bn to DKr1.57bn (\$272m) in the year ending September 30.

Mr Poul Svanholm, the outgoing chief executive who will be succeeded by Mr Flemming Lindelov next month, said the group was "not displeased" with the result, which was slightly above expectations. However, the most-traded B shares closed DKr7 lower at DKr375 in Copenhagen yesterday.

Carlsberg is poised to acquire a 20 per cent stake in the UK brewery group to be created from the merger of Bass and Carlsberg-Tedley. Completion of the merger,

announced on August 26, is being held up while an opinion is awaited from the UK competition authorities.

The Danish group is also negotiating to expand overseas for the first time in the soft drinks business. It is in talks with Coca-Cola to extend its co-operation in Denmark - covering production and distribution - to Sweden and Norway. This follows the US drinks group's decision to end co-operation with the Pripps brewery group in Sweden.

Mr Walter Paulsen, Carlsberg co-managing director, said the talks had not been completed, but "a positive outcome" was expected.

One-day profits were helped by rising returns from the group's financial assets, with net financial income increas-

ing DKr10m to DKr318m. Tax, however, rose 29 per cent from DKr343m to DKr444m, holding back the increase in group net profits, which rose 4.6 per cent, from DKr1.07bn to DKr1.12bn.

Earnings per share increased from DKr15.69 to DKr16.63. The dividend will remain unchanged at DKr3.40 a share.

Carlsberg's group operating profits increased DKr140m to DKr1.25bn. This was despite a DKr70m rise in sales and marketing costs to DKr1.30bn as the advertising spend was increased to support the Carlsberg and Tuborg brand names in core markets.

The group planned a further intensification of sales and marketing efforts, especially in China and other

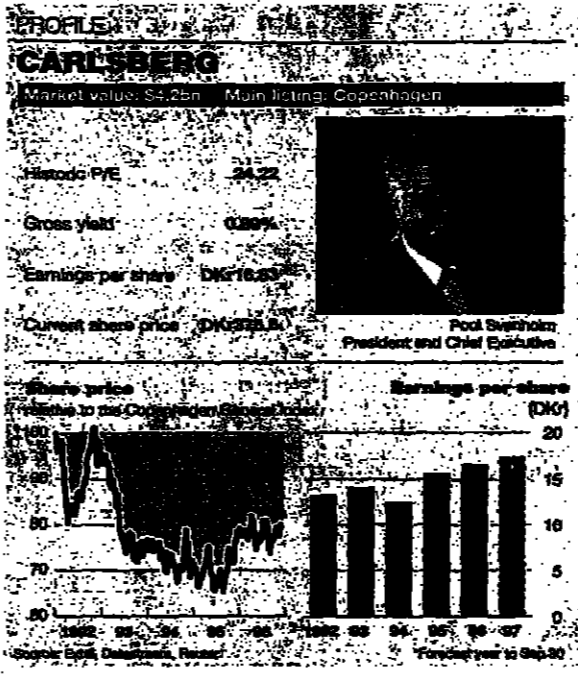
countries undergoing rapid development.

Mr Svanholm attributed the growth in operating profits, despite the sharp rise in sales and marketing costs, to improving productivity.

Sales increased 6.3 per cent, from DKr17.02bn to DKr17.96bn. Beer sales, of which 84 per cent were outside Denmark, rose 2.3 per cent to 22.3m hectolitres.

Carlsberg, which has increased worldwide beer sales 50 per cent over the past five years, said it expected continued steady growth, despite intense competition in an industry marked by growing concentration.

The group has a strong balance sheet, with equity capital at the end of last year of DKr8.91bn and assets of DKr20.46bn.



OBITUARY: Ludvik Kalma

Czech who smoothed path for Skoda's move west

Mr Ludvik Kalma, chairman of the Skoda Automobilová carmaker, who has died following a road accident, was the most prominent Czech presence at a company that in five years has gone from a struggling state-owned enterprise to a thriving international automotive business.

Mr Kalma's deliberate manner contrasted sharply with the more aggressive style brought to the dowdy but venerable company by its senior German executives,

after the Czech government sold Skoda to Volkswagen. This was one of the most significant east-west deals signed in the immediate aftermath of the democratic revolutions of 1989.

A veteran of the Czech motor industry, Mr Kalma joined Skoda in April 1991 after heading Motor Jikov, an automotive components plant in southern Bohemia, near the town of Ceske Budejovice where he was born in October 1941, and which he joined in 1960 as an engineer.

He took over at Skoda as the sale to Volkswagen was being finalised, and became the Czech company's public face.

As a huge investment programme got under way he helped smooth early tensions between Czech and German executives, pulling the company through a difficult transition without undue upheaval.

Today Skoda is the Czech Republic's largest exporter and expects to break even or post a profit this year, for the first time since the

arrival of Volkswagen, which now owns 70 per cent of the company.

Ironically, the car Mr Kalma was driving when it was in collision with a truck near the southern town of Tabor on Sunday night was Skoda's latest model, the Octavia, which he helped launch this autumn and for which the company has high hopes.

Skoda has spent heavily on building a new plant at Mlada Boleslav in the past two years to house a new assembly line for the

Octavia, which is based on Volkswagen's Audi and Golf models.

The Octavia was recently unveiled to much fanfare, with some Skoda dealers in Prague reworking their showrooms to display the model to best advantage.

It is already common on Czech roads, its sleeker lines in marked contrast to the boxy Forman and Favorit models Skoda once used to make.

Skoda hopes the Octavia will be a big export-earner, and some economists predict

the company will be responsible for up to 10 per cent of total Czech exports in two years.

Mr Kalma was chairman of the Czech automotive industry association and a vice-president of the Union of Czech industry. He is survived by his wife and three children.

Police reportedly charged the driver of the truck with causing the accident.

No successor at Skoda has yet been named.

Vincent Boland

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PANAMA
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Public Act of pre-qualification of companies and/or consortia for their participation in the Public Bid for the granting of the Concession of the Atlapa Convention Center and an area of 5 hectares + 7,136.19m² located in the Corregimiento of San Francisco, Province of Panama, Republic of Panama for the development and commercial operation of the Tourist Project object of the concession.

An invitation is hereby extended to the firms or consortia of firms interested in participating in the Act of Pre-qualification to present information that would support their technical, administrative and financial capabilities for the development, administration and commercial operation of the Atlapa Convention Center and an area of 5 hectares + 7,136.19m² located in the Corregimiento of San Francisco, Province of Panama, Republic of Panama based on Law 16 of July 14, 1992, Law 56 of December 27, 1995, Executive Decree No.18 of January 25, 1996, and other additional and complementary regulations.

Only those firms and/or consortia that have been pre-qualified can present proposals for this act of Public Bidding.

The required information to be presented by the firm (s) and/or the consortia must cover the following basic components:

1. Pre-qualification Application
2. All the documents, conditions and legal, technical and financial requirements as contained in the Pre-qualification Document.

The interested firms and/or consortia may pick up the Pre-qualification Document on or after Tuesday, November 12, 1996 at the offices of the Panamanian Institute of Tourism, 1st Base, ATLAPA Convention Center, Corregimiento of San Francisco, Panama City, Telephone: (507) 236-4614, Fax: (507) 236-3483 or request it by mail addressed to Mr. Pedro Campagnoni, General Manager, P.O. Box 4421, Panama 5, Panama.

The Pre-qualification instructions may be acquired by interested parties, after effecting a one thousand Bathos (B/1,000.00) payment in cash or in Certified Check to the Tesoro Nacional. This payment is non-refundable, and it constitutes a sole payment to cover the cost of applying for the Pre-qualification.

The Pre-qualification application and all the legal, financial and technical documentation required must be conveyed at the Public Act of presentation of applications that will take place on January 8 at 2:00 p.m. at the Choice Room of the ATLAPA Convention Center.

The Panamanian Institute of Tourism will not assume any cost which interested parties may have incurred in the presentation and delivery of the information and reserves the right to void, amend postpone or declare forfeited the Act of Pre-qualification.

Issued in Panama City on October 31, 1996.

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Santander Investment

October 1996

COMPANIES AND FINANCE: THE AMERICAS

AMERICAS NEWS DIGEST

Applied Materials buys Israeli group

Applied Materials of the US, one of the leading suppliers of water fabrication systems and services to the global semiconductor industry, yesterday announced it was paying \$225m for all of Opal and Orbot Instruments, subsidiaries of Citel Industries, the Israeli conglomerate.

The move will give Opal and Orbot Instruments, leading suppliers of CD-SEM systems and wafer and recticle inspection systems respectively, greater access to a larger customer base on the back of Applied Materials' global infrastructure. The Santa Clara-based company had revenues of \$4.1bn this year, a 35 per cent increase on last year. Net income rose nearly one-third, from \$400m in 1995 to \$600m in 1996. The Asia market accounts for more than 50 per cent of sales. The deal will also give both companies greater access to capital for research and development. Opal, which recently acquired ICT, the German scanning electron microscope maker, had sales of \$82m for the 12 months to September 30. Orbot Instruments had sales of \$36m over the same period.

Applied Materials will tomorrow begin a cash tender offer for all outstanding shares of Opal's common stock at a net \$18.50 a share, amounting to about \$175m. It will pay \$110m in cash for Orbot Instruments.

Judy Dempsey, Jerusalem

Mexican coal terminal agreed

Grupo Mexicano de Desarrollo (GMD) and the Mexican subsidiary of Techint, the Italian company, have signed an agreement with Mexico's Federal Electricity Commission to build a \$230m-250m coal terminal for an electricity generator in Petacalco, southern Mexico.

Over the weekend it was announced that GMD and Techint had won a competition for the 30-year concession to build and operate the coal terminal for the 2100MW Petacalco generator, which can be powered by either coal or fuel oil. The decision ended a process which had begun in 1993 and which, like many other Mexican energy projects, had been stalled by financing and contractual concerns.

GMD, one of Mexico's biggest construction firms, was severely affected by Mexico's sharp recession and continues to suffer from the failure of expensive toll-road projects.

Daniel Dombey, Mexico City

Help for Canadian Airlines

Mr David Anderson, the Canadian federal transport minister, yesterday became involved in negotiations to save Canadian Airlines International from a threatened cash crisis next January. The airline at the weekend reached a settlement with its 2,700 flight attendants for a contract to replace one that expired a year ago.

Details were not available, but the new contract does not cover a 10 per cent across-the-board pay cut being demanded by CAI as part of its latest restructuring plan. CAI pilots have agreed to the cut and its machinists say they will accept a cut for the higher-paid. But the ticket agents and other unions oppose any cut.

Mr Kevin Benson, CAI president, is negotiating a C\$48m (US\$35.8m) reduction in the cost of services provided by American Airlines, which has a 25 per cent voting interest in CAI. Concessions are also being sought from other suppliers.

Mr Anderson, who represents a British Columbia constituency, said he would consider helping CAI only when the restructuring was fully in place. But CAI shares firmed 50 cents to C\$2.30 yesterday following the new round of talks.

Analysts now expect the restructuring deadline of November 29 to be extended. Altogether, CAI seeks about \$150m of immediate cost-savings to see it through the critical post-Christmas season. *Robert Gibbens, Montreal*

Light back in black

Light, the Rio de Janeiro electricity group which in May became Brazil's biggest privatisation so far, returned to the black in the first nine months of this year with net profits of R\$76.29m (US\$74m). This compares with a loss of R\$59.5m in the same period last year. Revenues rose to R\$1.16bn from R\$916.8m.

The group, which has around 9 per cent of the Brazilian electricity distribution market, said it had invested \$45m on improvements to its infrastructure since privatisation. The sale of Light, which was the second electricity distribution company in Brazil to be privatised, raised \$2.22bn for the government. Electricité de France, along with two US partners, emerged as the largest shareholder, taking 34.7 per cent. Electrobras, the federal government's electricity holding company, retains a 21.5 per cent stake, while CSN, a Rio de Janeiro steel group, bought a 7.25 per cent holding.

Along with Cerj, the Rio de Janeiro electricity distribution company privatised last week, Light is still waiting for the government to finalise the regulatory framework it will operate under in the private sector. However, the company has already been given approval by the government to raise its tariffs in line with inflation next year, which was seen as a signal that the company would not be subject to political interference.

Geoff Dyer, São Paulo

Aiwa signs Brazilian deal

OCE, the Brazilian electronics company, has struck an agreement with Aiwa, the Japanese electronic goods maker, to produce Aiwa stereos in Brazil for sale in the Mercosur customs union. The two have so far invested \$30m in the deal and OCE expects to begin output of Aiwa stereo mini-systems in 1997.

Reuter, São Paulo

Borland names chairman

Borland International, which provides products and services to software developers, said it appointed Mr Delbert W. Yocum, a former senior executive at Apple Computer, as chairman and chief executive officer. Mr Yocum, who will begin work on December 2, served as Apple executive vice-president and chief operating officer from 1986 to 1988, and president of Apple Pacific from 1988 to 1989. He also served as president and chief operating officer of Tektronix.

Reuter, California

CBL pays \$86.4m for mall

CBL & Associates Properties, the US real estate investment trust, acquired St Clair Square, a 1.04m sq ft mall in Fairview Heights, Illinois, for \$86.4m. The mall is 93.7 per cent occupied, with sales in 1995 of \$328 a square foot. The company said the acquisition was funded on an interim basis with a \$66m loan from Wells Fargo bearing interest at 150 basis points over Libor with a three-year term and a two-year extension option. The balance of the purchase price was funded through the company's credit facilities. Based on annualised revenues from signed leases in place, the net operating income from the property is expected to be about \$7.7m for 1997.

AP-DJ, Tennessee

AOL tightens link with Excite

America Online has agreed a deal to make Excite the exclusive Internet search and directory service for America Online's more than 7m subscribers. In addition, Excite will acquire AOL's WebCrawler search and directory service for about 2m Excite shares, raising AOL's holding in Excite to about 20 per cent from its current 10 per cent.

The companies will also explore ways to better integrate "smart search" capabilities throughout America Online's information channels.

Reuter, Virginia

KeyCorp plans national network

By John Authers in New York

KeyCorp, the Cleveland-based commercial bank, yesterday announced it was taking a \$100m charge for this quarter and laying off 10 per cent of its workforce as part of a restructuring designed to create a national branch network.

The restructuring is the final step of the bank's plan to prepare for the lifting of legal restrictions on interstate banking next year. It now has 12 separate banks operating in 44 states, in four regional systems.

It also comes in response to pressure from Wall Street for cost-cutting in its huge branch network, which was formed largely by the merger of Society Banks and

KeyCorp in March 1994. The interstate banking legislation, which was passed in 1995 and comes into force in July next year, allows banks to open branches in more than one state. According to current federal law, banks can own branches across state lines, but each state branch network is legally separate. This is inconvenient for depositors and creates extra expense for the banks.

Now, KeyCorp says, it will be able to operate "like McDonald's or Sears", as a retail chain.

After the restructuring, KeyCorp, which has assets of about \$66bn, will be reduced to two nationwide distribution systems - a national retail branch network and a centralised head

office known as KeyBank USA. KeyBank USA will sell products such as credit cards, auto loans and home equity finance, and will increasingly use new methods of distribution such as 24-hour telephone lines and the Internet.

The charge includes \$22m in redundancy payments, to meet the 2,700 job losses which will be distributed throughout the company. KeyCorp will also close or sell about 140 of its branch offices - mostly in rural areas - to leave it with about 1,000, incurring a charge of \$20m.

The branch network is intended to focus on community and corporate banking products and services, while its personnel will be trained

to look for cross-selling opportunities for other products.

KeyCorp had made several strategic acquisitions and disposals over the last 18 months as part of the strategy, buying a car finance lender and a merchant bank, and disposing of its mortgage processing business.

A further \$28m will come from technology write-offs. Several of its present systems are used only to run its multi-bank structure and would become redundant.

Mr Bob Gillespie, chief executive, predicted that the restructuring would add about \$110m to annual earnings by the end of 1997.

Wall Street appeared to endorse the package, and the company's share price rose 5 1/4 to 9 1/2% in early trading.



Bob Gillespie: restructuring will add \$110m to earnings

Argentine airline poised for US partnership

By David Filling in Buenos Aires

Aerolíneas Argentinas expects to sign a code-sharing agreement with a big US carrier within weeks.

The deal could include the purchase of an equity stake in the Argentine flag carrier, according to company president Mr Manuel Morán.

Under the deal, Aerolíneas would

be likely to increase the frequency of its flights to Miami, New York and Madrid - which are among its most profitable destinations - while sharing other routes with its new partner.

Aerolíneas, which hopes to return to a modest profit in 1996 after several loss-making years, is operated by Iberia, the state-owned Spanish carrier.

Iberia took control of Aerolíneas

when it was privatised in 1990, but now holds only a 20 per cent stake after an EU ruling on a rescue plan for the Spanish airline forced it to sell several loss-making assets.

American Airlines, which is understood to be the principal contender, would not confirm reports of an imminent agreement with Aerolíneas, saying only that "we talk to a lot of people a lot of the time".

Although it does not have a track-record of buying stakes in other airlines, American did not rule out such a move. "We will do whatever we need to stay competitive," it said.

A further 63.35 per cent of Aerolíneas belongs to Interinvest, a consortium formed by Teneo, the Spanish state holding company, as well as US investment banks Merrill Lynch and Bankers Trust.

The Argentine government holds 5 per cent, airline employees a further 10 per cent, and local investors the remaining 1.65 per cent.

Last May, Aerolíneas agreed to the sale for \$140m of its 89 per cent stake in domestic airline Austral to Interinvest.

In the six months before the sale, Aerolíneas had lost \$134m, while Austral had registered a profit of about \$10m.

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COMPANIES AND FINANCE: THE AMERICAS

Prozac approved as bulimia treatment

By Tracy Corrigan
in New York

Prozac, the antidepressant developed by Eli Lilly, has been approved by the US Food and Drug Administration for the treatment of bulimia nervosa. It is the first medicine to be cleared by the FDA for the treatment of the eating disorder, which affects more than 1m Americans, almost exclusively women, each year. Prozac is the world's most widely prescribed branded antidepressant, with worldwide sales of \$1.75bn for the

first nine months of this year. But its growth is slowing: Prozac sales are expected to increase about 13 per cent this year, compared with 24 per cent in 1995, according to Mr Kenneth Kulju, a pharmaceutical analyst at UBS in New York. The drug faces growing competition from new antidepressants, Pfizer's Zoloft and SmithKline Beecham's Paxil. While the latest approval for Prozac is not expected to propel sales back to the phenomenal growth rate of the drug's early days, "each new approval generates confi-

dence that it is a very safe medication," Mr Kulju said. The likely impact on sales of the bulimia approval is difficult to estimate. The potential market of 1m sufferers is large, but some bulimia sufferers may already be prescribed Prozac: it has already been approved by the FDA for the treatment of clinical depression and obsessive-compulsive disorder, and about 80-90 per cent of bulimia sufferers also suffer from depression, according to Dr Mark Demitrack, a clinical research physician at Eli Lilly.

It is also believed that less than 25 per cent of bulimia sufferers are diagnosed with obsessive-compulsive disorder. Furthermore, doctors can prescribe drugs for non-approved uses. However, psychotherapy has traditionally been the primary treatment for bulimia. According to Dr Freda Lewis-Hall, director of the Lilly Center for Women's Health, the ideal treatment for most patients is likely to be a combination of medication and psychotherapy. Efficacy studies for bulimia show that the effect of Prozac on sufferers is not

dependent on whether or not the patient is depressed, Dr Demitrack said. In eight-week clinical trials, women treated with 60mg of Prozac daily experienced a 67 per cent decrease in binge-eating and a 56 per cent decrease in self-induced vomiting. The use of Prozac to treat anorexia nervosa, an eating disorder involving food deprivation rather than bingeing, is currently being tested. Anorexia is believed to affect only 1 per cent of the population, compared with 3 per cent for bulimia, according to Eli Lilly.

Conseco finds strength in acquisition strategy

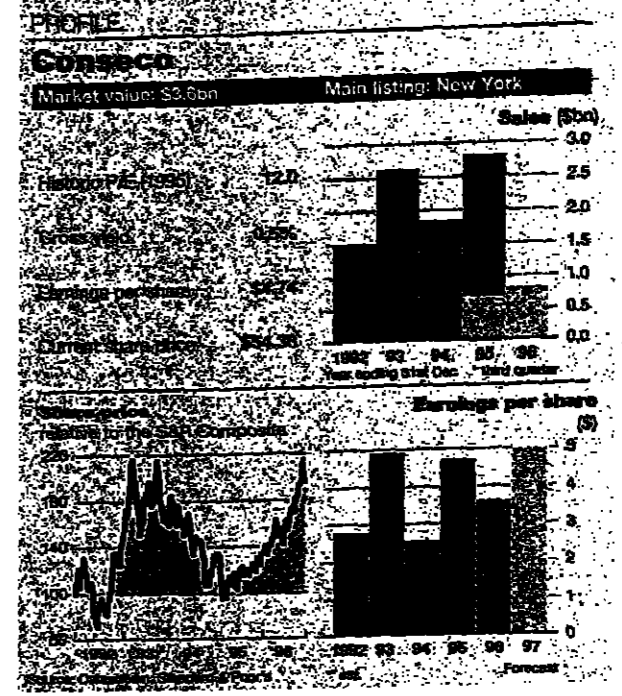
The US group's 10-year buying spree has sent an unwelcome message to the insurance industry

The US life insurance industry was not ready for Mr Stephen Hilbert. But now that Conseco, the Indiana-based company he started in 1979, has bought 22 life companies within a decade, making it one of the largest concerns in the current wave of consolidation hitting the industry, it has no alternative but to pay him attention. In April this year, Conseco joined the Fortune 500 group of companies, of which it has the second-highest total return over the past 10 years. Once its latest agreed acquisitions are completed, it will have \$30bn in assets under management, annual premium income of \$6.8bn, and a cash flow of about \$650m in projected annual earnings before interest and taxes.

Mr Hilbert's message - that the industry needs to consolidate - is not welcome, but it is endorsed by many industry observers. They believe the sector cannot compete with the banks, which are now steadily being freed by regulators to sell insurance, or with mutual fund companies which are diversifying into life products. "I believe the small life company today is absolutely doomed. Consolidation is not an option. It's a necessity," Mr Hilbert told a conference in New York earlier this month. "All you have to do is take a look at the financial services sector. Then you look at the life insurance industry and we look like Mom and Pop's corner stores."

He blames mismanagement for the problems: "The opportunity I saw was a wonderful industry which was totally under-managed. Self-preservation always came first. They were inside-the-box managers - same old products, same old distribution and little need to manage costs." "This meant life companies ceded opportunities to rivals elsewhere in financial services: "When I think of the mutual fund industry today it makes me want to throw up. That should be our business. All of those clients were our customers and we didn't have the foresight to take advantage of it."

The only way they knew to compete, he said, was by making "dumb investments" - meaning the sector's ill-fated foray into real estate in the late 1980s. If this sounds arrogant, then at least Mr Hilbert can speak with the authority of strong stock market performance. Since it floated in 1985, Conseco stock has had a 56.5 per cent compound annual growth rate, generated by acquisitions and fierce internal cost-cutting. Its results for the third quarter of this year continued the trend, with earnings per share, at \$1.01, significantly exceeding the consensus of analysts' forecasts for 94 cents. Cost savings from the latest acquisitions helped. During the quarter, Conseco had completed the acquisition of



'I believe the small life company today is absolutely doomed. Consolidation is not an option, it's a necessity,' Mr Hilbert told a conference in New York earlier this month

Life Partners Group, and consolidated its headquarters into the head office near Indianapolis, reducing annual operating expenses by \$25m. It plans to cut another \$10m-\$15m next year by using improved administration systems. Conseco has not been on an undisciplined buying spree, a charge which could possibly be levelled against GE Capital, the only company to have spent more on life acquisitions in the past few years. Instead, the Conseco strategy has been to focus on specific niches where it sees opportunities for growth, and where it has developed some expertise. This means long-term care insurance, which pays for nursing home care for the elderly, cancer insurance, Medicare supplement insurance - also aimed at the elderly - and a range of annuities. The theory is that US demographics, with the generation born in the post-war "baby boom" now beginning to reach their 50s, will drive growth in all of these markets. Reforms to healthcare and entitlements, now at the top of the political agenda, could also help the sector. Further, the acquisitions have built a diversified distribution network of 90,000 employee agents, who can each generate sales for other Conseco companies. The acquisition campaign to build the business underwent three distinct phases. The seven purchases made between 1982 and 1989 were all wholly-owned subsidiaries, bought with debt.

This strategy grew harder to operate, however, as rating agencies began to clamp down on the life insurance sector in the wake of its real estate losses. Thus between 1990 and 1994 Conseco bought another five life companies using a partnership, including GE Capital among its partners. This kept the acquisitions off Conseco's balance sheet. Since 1994, the company has been buying its partners out, and has made six acquisitions using its own paper as well as debt. Its target, made to keep in line with the rating agencies, is to have no worse than a 35 per cent ratio of debt to capital. The strategy for the future is to keep on acquiring, although Mr Hilbert insists he would not "do any deal which comes along", or get involved in an auction. Further ahead, Conseco might look at joint ventures in Europe, and marketing alliances with US banks. Internally, the aim is to persuade as many employees as possible to take a stake in the company. As a former door-to-door encyclopaedia salesman, who started out as a life insurance salesman, Mr Hilbert believes that the industry, still dominated by mutuals, has been held back by a lack of incentives: "About 35 per cent of our associates are shareholders and I'd like to make that 100 per cent. I have 6.8m shares. That's putting your money where your mouth is."

John Authers

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October, 1996

INTERNATIONAL CAPITAL MARKETS

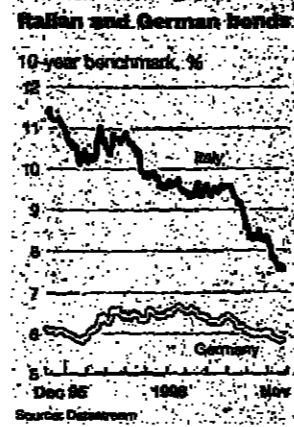
Re-entry into ERM bolsters Italian BTPs

GOVERNMENT BONDS
By Richard Adams in London and Lisa Branstetter in New York

Optimism over Italy's re-entry into the European exchange rate mechanism helped Italian government bonds (BTPs) shrug off bad news on markets yesterday.

points from last week. The 10-year benchmark ended at 112.74, a rise of only 0.1, to yield 7.57 per cent.

Analysts in London said that the lira's re-entry into the ERM had been already priced in, and questioned how much "convergence" optimism Italian bonds had left in them.



Italian and German 10-year benchmark yields. Source: Bloomberg.

was a great temptation to take profits from the rise in Italian bonds to date. "I think it's a case of sell the reality of [Italy's] membership of the [ERM]," he said.

Ms Alison Cottrell, economist at PaineWebber in London, thinks Italian bonds could yet go higher, with low inflation figures and interest rate cuts from the Bank of Italy to come.

of 10-year 7.75 per cent BTPs; and £2.50bn of seven-year floating-rate certificates (CCTs) paying a first coupon of 3.80 per cent.

In Belgium, there was little impact from the monthly OLO auction. The Belgian Treasury accepted bids for BF15.7bn worth of bonds, BF7.8bn for redemption in March 2001, and BF7.9bn for redemption in March 2007.

Trading in UK gilts was quiet ahead of the budget. Long gilt futures settled at 111 1/4, up 1/4.

US Treasury prices regained some of the losses of last week as the dollar gained and economic data was friendly to the market.

Near midday, the benchmark 30-year Treasury was 4 1/8 stronger at 101 3/4 to yield 6.412 per cent, while the two-year note was up 1/4 at 99 3/4, yielding 5.659 per cent.

Trading was expected to be quiet with Treasuries staying in a narrow range for most of the week, which will be interrupted by the Thanksgiving holiday.

Denmark taps demand for sterling bond issues

INTERNATIONAL BONDS
By Samer Iskandar

Denmark yesterday took advantage of investor demand for sterling bonds with the issue of £100m of four-year notes.

Daiva Europe, the lead manager of the Denmark issue, said the launch was motivated by a large lead order from Japan, although some paper was also sold in the UK, Italy and the Benelux region.

Sanctuary, the UK's fourth largest housing authority, was priced to yield 75 basis points over gilts maturing in 2021, although this date does not match the bonds' maturity - 65 per cent of the amount is gradually redeemed between 2014 and 2021, when the remaining 35 per cent of the principal is repaid.

New international bond issues

Table listing new international bond issues with columns for Issuer, Amount, Coupon, Price, Maturity, Yield, Spread, and Book-runner.

Final terms, non-callable unless stated. Yield spread (over relevant government bond) at launch as priced by lead manager. *Indicated as floating-rate notes. S: Convertible. R: Redeemable. F: Fixed. C: Callable. P: Puttable. U: Unsecured. B: Secured.

WORLD BOND PRICES

Table of benchmark government bonds with columns for Country, Coupon, Price, Days to Maturity, Yield, and Week Change.

EUROPEAN BOND FUTURES

Table of European bond futures with columns for Strike, Price, Call, Put, and other details.

UK Gilts Prices

Table of UK gilt prices with columns for Maturity, Price, Yield, and Change.

FT Actuaries Govt. Securities

Table of FT Actuaries government securities with columns for Price, Yield, and other details.

UK Indices

Table of UK indices with columns for Index Name, Current Value, and Change.

US INTEREST RATES

Table of US interest rates with columns for Rate Type and Yield.

US Treasury

Table of US Treasury bond prices with columns for Maturity, Price, and Yield.

Spain

Table of Spanish bond prices with columns for Maturity, Price, and Yield.

Japan

Table of Japanese bond prices with columns for Maturity, Price, and Yield.

FT/ISMA International Bond Service

Table of international bond service with columns for Issuer, Maturity, Price, and Yield.

BOND FUTURES AND OPTIONS

Table of bond futures and options with columns for Contract, Price, and Yield.

Germany

Table of German bond futures with columns for Maturity, Price, and Yield.

Other Fixed Interest

Table of other fixed interest securities with columns for Issuer, Maturity, Price, and Yield.

FT/ISMA International Bond Service

Table of international bond service with columns for Issuer, Maturity, Price, and Yield.

US Dollar Straddles

Table of US dollar straddles with columns for Maturity, Price, and Yield.

CAPITAL MARKETS NEWS DIGEST

MTRC wins fine terms on loan

Hong Kong's Mass Transit Railway Corporation, one of the territory's leading borrowers, yesterday launched a HK\$5.5bn syndicated loan, the corporation's sole significant fund-raising exercise for the year.

Advisers discuss Chinaclear

China yesterday took another step forward in its aspirations to join the ranks of established international capital markets, when foreign advisers met in Beijing to discuss progress made on the Chinaclear project.

IBCA sets Egyptian bank

IBCA, the European Credit rating agency, has assigned an individual rating of B/C to Commercial International Bank, the sixth largest Egyptian bank ranked by total assets.

UK Gilts Prices

Detailed table of UK gilt prices with columns for Maturity, Price, Yield, and Change.

Germany

Detailed table of German bond futures with columns for Maturity, Price, and Yield.

Other Fixed Interest

Detailed table of other fixed interest securities with columns for Issuer, Maturity, Price, and Yield.

FT/ISMA International Bond Service

Detailed table of international bond service with columns for Issuer, Maturity, Price, and Yield.

US Dollar Straddles

Detailed table of US dollar straddles with columns for Maturity, Price, and Yield.

FT Fixed Interest Indices

Table of FT fixed interest indices with columns for Index Name, Current Value, and Change.

Glit Edged Activity Indices

Table of glit edged activity indices with columns for Index Name, Current Value, and Change.

FT/ISMA International Bond Service

Table of international bond service with columns for Issuer, Maturity, Price, and Yield.

US Dollar Straddles

Table of US dollar straddles with columns for Maturity, Price, and Yield.

Other Fixed Interest

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Table of UK gilt prices with columns for Maturity, Price, Yield, and Change.

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FT/ISMA International Bond Service

Table of international bond service with columns for Issuer, Maturity, Price, and Yield.

ITALY: FINANCE, INDUSTRY AND EXPORTS

A fresh relationship emerges

A new partnership seems to be forming between industry and the state. The dismantling of Iri may concentrate politicians' minds on the legitimate uses of industrial policy in a modernising economy. Andrew Hill examines developments

It is always dangerous to signal the end of an era in Italy. But when, earlier this month, Mr Carlo Azeglio Ciampi, Italy's treasury minister, called a halt to nearly seven decades of industrial policy exercised through Iri, the state holding company, he seemed to be heralding a significant change in the relationship between the state and industry.

The government, said Mr Ciampi in a statement, "considers that Iri's mission as a public holding of big industrial and service companies operating under state monopoly has come to an end".

The private sector, meanwhile, is undergoing its own shock treatment. Last Sunday's agreement on re-entry of the Italian currency into the European exchange rate mechanism (ERM) underlined that entrepreneurs would have to learn to live with a stronger lira, four years after departure from the ERM ushered in a period of export-driven growth.

For a government bent on bringing its economy into line with Europe, both events were inevitable. Not that anybody expects Iri to disappear overnight. Mr Ciampi's statement was part of a decision to merge two of Iri's largest quoted holdings - Stet, the telecoms group, and its main operating subsidiary Telecom Italia - and

give the treasury direct control of the merged company ahead of privatisation next year.

The effect is to delay the long-awaited sell-off once again and to underline another Italian paradox, that - as one newspaper put it tartly - "in order to privatise, you first have to nationalise the company by giving control to a ministry". Even after asset transfers and privatisations, Iri will still be a significant economic force, with controlling stakes in Alitalia, the troubled airline, RAI, the broadcaster, Finmeccanica, the defence and engineering conglomerate, and Financieri, the ship-builder.

If nothing else, however, the dismantling of Iri may concentrate politicians' minds on the legitimate uses of industrial policy in a modernising economy - be- lieved state subsidies and murky government-backed rescue plans. Optimists believe it may even prompt the founding families who run many of Italy's dynamic private-sector enterprises to think about splitting ownership and management of their small and medium-sized companies in the drive to confront aggressive international competition.

Until recently, Italy's industry ministry has literally been in the shadow of Iri: until 1990 it was known as the ministry of state hold-



Benetton factory near Treviso. The level at which the lira might enter the ERM is of immediate concern to some companies. Trevor Hurrell/Reuters

ings and its offices are next door to Iri's headquarters on Rome's Via Veneto.

The decline of the state sector poses new challenges, according to Mr Pier Luigi Bersani, industry minister since the centre-left's election victory last spring.

"We have to leave behind the era of direct intervention

Inflation is coming down, exchange rate volatility has calmed, and the Bank of Italy did finally cut interest rates this autumn. But business and consumer confidence is still afflicted by uncertainty about the economic and political future.

Consumer demand in Italy is flat or falling. Car registrations in the 10 months to end-October have risen only 0.6 per cent compared with the same period of 1995, and car dealers and manufacturers are again calling for government-led incentives to encourage a recovery in demand. The latest industrial production statistics showed a decline of 2.9 per cent in September, compared with the same month of 1995.

The country's trade surplus - according to Mr Augusto Fantozzi, the minister for foreign trade - should still reach a record L60,000bn-L70,000bn this year, against L45,000bn in 1995, when exports were helped by a much weaker lira. But analysts point out that margins are being squeezed, and the main reason for the growing surplus is that the slump in consumer demand means imports are declining faster than exports.

The strengthening of the lira is the first real test of the export-backed growth of previous years. Mr Bersani is confident that small and medium-sized companies are tenacious enough to consolidate their international positions now that times are harder.

"Price helps to give industry opportunities and in this sense, Italian industry has a great capacity to take advantage of such situations," he says.

"But once our small and medium-sized enterprises have gone into foreign countries it isn't easy to dislodge them... They succeed in sticking there because they have, for example, flexibility in production capacity."

According to some analysts, however, fast-moving small companies are still let down by a less-than-dynamic banking sector, and a reluctance to seek risk capital for the financing of growth.

Mr Luciano Balbo, chairman of B&S Electra, an Italian venture capital group, points out that Italy has become strong in certain areas, such as machine tools and textiles, thanks to family-owned companies. But he warns:

"Almost none of these companies has become large, and too often they end in collapse. These days, in mature sectors, you can't

grow simply through internal growth."

To modernise the Italian financial system, many look to privatisation of the country's banks - many of which are still owned by centuries-old public-sector "foundations" - the growth of home-grown pension funds and other institutional investors, and a consequent increase in the importance and status of the Italian stock exchange.

"At the moment, smaller businesses don't have many alternatives to the banking system," says Mr Giorgio Fossa, elected chairman of Confindustria, the employers' federation, in May. "Some time in the future, we should become like the US, where 80 per cent of new capital comes from institutional investors. If there was a real financial market, we would also manage to separate families from management."

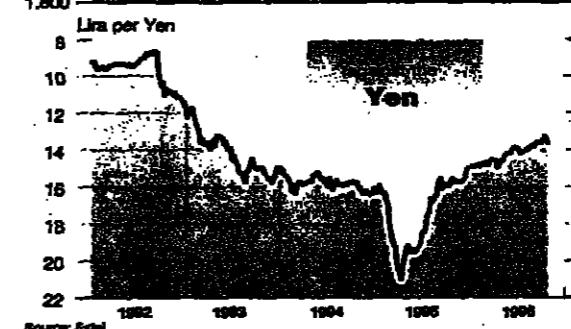
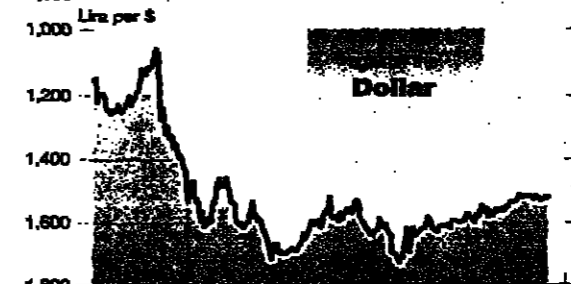
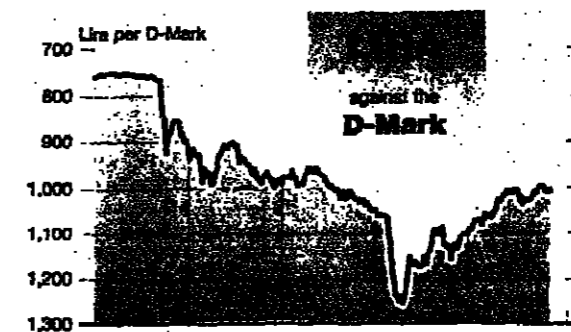
Unfortunately, deep reform of the financial system is still easier said than done. Foundations are the original vested interests in most Italian cities, and difficult to dislodge from their privileged positions. At the same time, the banking system is cracking under the weight of bad loans - particularly those built up in the poor south of the peninsula - which between 1993 and 1995 increased at an annual

rate of 26 per cent. It is not the best moment to be considering a launch onto the high seas of the private sector.

In a speech at the end of October, Mr Ciampi outlined new draft legislation, which would attempt to loosen the foundations' hold over their banking subsidiaries and encourage them to invest elsewhere, partly by removing some of the fiscal deterrents to such flotations.

"The results [of previous legislation] have not been sufficient," said the minister. But many critics of Mr Ciampi's approach believe the new legislation will still be too soft, and that the foundations should be obliged to sell majority stakes in their banks.

In the end, coercion may achieve less than the cold realities of the modern market. The decline of Iri is a



Source: ERM

further indication that the other easy alternatives for financing big business - direct or indirect transfers from the state - are no longer viable. Meanwhile, the reduction in interest rates and the narrowing gap between the yield on Italian government bonds and German or British equivalents is making equity investment more attractive for the average Italian saver, until now a devotee of investment in government bonds.

The theory is that, under such circumstances, a new generation of family-based entrepreneurs may turn to professional management and the stock market to realise their 21st century ambitions, rather than to banks or the government. But as the slipping calendar for privatisation of Stet suggests, it might be best not to hold your breath.

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EXHIBITION CALENDAR 1997

January

January, 17-20
35° SALONE INTERNAZIONALE DEL GIOCATTOLO '97
International Toy exhibition - Model - Making, Hobby, Christmas decorations, Carnival items

January, 17-20
CHIBI '97
International exhibition of gift articles, perfumery items, costume jewellery and smokers' supplies

January, 17-20
CART '97
International exhibition of stationery, paper and cardboard products, articles for school and fine arts

January, 17-20
CHIBIMART '97
Exhibition Market of Handicraft Typical Products

January, 18-20
PROGETTO INTIMO 1997
Underwear Exhibition

January, 25-26
XXXII ESPOSIZIONE INTERNAZIONALE CANINA DI MILANO
32nd International Dog Show in Milan

January, 26-28
MIAS INVERNALE '97
International sportswear, sports and camping equipment exhibition

February

February, 7-10
MACEF PRIMAVERA '97
International exhibition of Tableware, Household and Gift items, Silverware, Goldsmith's items, Watches

February

MILLAPIS
Exhibition of Marble, Granite and Natural Stone in Architecture, Interior Design and Art

February, 21-23
SALONE DELLO STUDENTE - CAMPUS ORIENTA
School and training courses guidance

February, 21-23
MIFLOR '97
International exhibition of Floriculture, Plants and Gardening Accessories

February, 21-24
SABEN
Exhibition-Conference Nature and Health

February, 25-27
W.I.T.
World Investment in Tourism - Conference & Exhibition

February 26 - March 2
BIT '97
International Tourism Exchange

February 28 - March 4
MODAMILANO - MILANOVENDEMODA
Women's Wear Collections

March

March
MILANO COLLEZIONI DONNA
Women's Wear - Autumn/Winter 1997-1998 Collections

March, 3-5
MODA IN - TESSUTO & ACCESSORI
International clothing textiles and accessories exhibition

March, 4-6

PROMOTION EXPO
Exhibitions of objects for promotion and business gift. Promotional services, materials and objects for point of purchase advertising

March, 6-9
CARTOONICS - "R" - ACTA DIDATTICA

March, 13-16
71st MIPEL
International leather goods market

March, 13-17
MIFUR
Fur and leather exhibition

March, 18-22
IPACK-IMA '97
International exhibition Packing and Packaging, Mechanical Handling, Food-processing Industrial Machinery

March, 19-22
TAU EXPO '97
6th International Environmental Technologies and services Conference Exhibition. 6th Human Protection, Civil Defence and Fire-fighting exhibition

March, 21-23
MILANOFIL '97
International Philatelic exhibition

March, 21-24
MIART
Modern and contemporary art exhibition

2 ITALY: FINANCE, INDUSTRY AND EXPORTS

The banking sector by David Lane

'Frankenstein' law failed to deliver

Italy's banks must address a daunting list of crucial adjustments

Frankness is a rare quality in politicians. But in describing the July 1990 law that bears his name as a legislative Frankenstein, Giuliano Amato, former treasury minister and prime minister and now head of Italy's competition watchdog, gets near the truth.

The Amato law aimed to revolutionise the banking system by turning public-sector banks into joint stock corporations, and then merging and privatising them. Under the law, public sector banks were given tax breaks to spin off their banking operations into joint stock corporations (società per azioni - SpA), the equity remaining with foundations controlled by local governments.

While public-sector public law credit institutions - a category including San Paolo di Torino and Monte dei Paschi di Siena - and casse di risparmio savings banks - a category including Milan's Cariplo - have been transformed into "SpA", the much-sought mergers and privatisations have not happened.

There were 163 "SpA" at the end of last year, against 187 at the end 1991, the year when the law started to be applied. The number of banche popolari (generally small and medium-sized people's banks) fell from 103 to 96 and the number of co-operative credit banks (usually one or two-branch affairs) from 710 to 619.

Excluding the branches of foreign banks, refinancing institutions and medium- and long-term banks, the number of Italian banks dropped from 1,000 to 878 between 1991 and 1995.

The Bank of Italy reports that there were 64 concentration operations last year, of which 28 involved co-operative credit banks. Most were acquisitions; there were just 10 mergers.

The central bank notes

that some well-performing medium-sized banks in central and northern Italy have been the most active in growing through concentration operations. Italian banking remains fragmented overall, however.

No big merger operation has been undertaken in the past five years since those between Cassa di Risparmio di Roma, Banco di Santo Spirito and Banco di Roma (to form Banca di Roma) and between Nuovo Banco Ambrosiano and Banca Cattolica del Veneto, forming Banco Ambrosiano Veneto.

The Credito Italiano/Credito Romagnolo operation two years ago did not lead to merger. Milan's stock market quotes Rolo Banca 1473 as well as Credito Italiano.

Figures published by Associazione Bancaria Italiana (the Italian banking association, ABI) and IBCA in their European banking report in July reveal a level of fragmentation matched only by Germany.

The three largest banks together control just 20 per cent of the market in Italy, against 54 per cent in Britain and 74 per cent in the Netherlands, where concentration is greatest.

The 10 largest banks take 50 per cent, compared with 85 per cent in Britain and 93 per cent in the Netherlands.

Currently being salvaged, Banco di Napoli will keep its identity even if it is acquired by a large Italian bank, thereby nullifying the benefits that could result from

merger. Apart from providing a sop to southern interests, that is the Italian pattern.

Several banks whose shares are listed on the Milan board are controlled by other banks: Banca Nazionale dell'Agricoltura by Banca di Roma; Banca Toscana by Monte dei Paschi di Siena; and Banca di Chiavari and Banco di Legnano by Banca Commerciale Italiana. Little wonder that the authorities are disappointed about progress towards concentration.

Scarce achievement on privatisation owes much to Mr Amato's law. The "monster" foundations have kept control of the banks, in spite of efforts by successive governments.

Two years ago, Mr Lamberto Dini, the treasury minister, issued a directive allowing foundations five years to diversify and disinvest from banking. The results are risible. Now Mr Carlo Azeglio Ciampi, who took over from Mr Dini as treasury minister, is attempting to move matters along.

When, as governor, Mr Ciampi addressed the Bank of Italy's annual meeting in May 1995, he noted that 65 per cent of Italy's banking system was in the public sector. Seven years later and after legislation aimed at promoting privatisation, ABI describes how little has been achieved.

"The only European banking market where large banks are mainly under public control is Italy, 11 of 17 banks considered belonging directly or indirectly to public bodies," says the ABI. This massive presence of public-sector banks is confirmed by total asset figures.

One reason why privatisation has not happened is politics: national and local politicians can keep their hands on the banking levers through the foundations.

Being involved with banks is more rewarding than running portfolios of financial investments (which would probably be done by professional investment managers) and distributing the income from them.

Another reason is that foundations' book values of their bank shares are higher than market values. A third reason is adverse stock market conditions.

San Paolo di Torino has not followed up the initial public offering (IPO) of 20 per cent of equity made in March 1992 with a secondary operation. Cariplo was forced to abort an IPO in which it hoped to offer 22 per cent of its equity in July 1994.

In generally unfavourable stock market conditions, bank shares have been especially unpopular.

This is not surprising given banks' dismal profit records and passed or reduced dividends.

In their banking report, ABI and IBCA note that Italian banks' return on equity has fallen from 11 per cent

in the period 1987-1989 to 2 per cent over 1993-1995, considerably lower than most leading European banking markets and even below France.

Self-financing was negative in 1994 and only just positive last year.

The biggest factor underlying the profitability gap between Italian banking and the rest of Europe is taxation which explains 39 per cent of the difference: profits incur 56 per cent tax against 30 per cent in Britain and the Netherlands.

Higher staff costs and poorer risk management account for about 22 per cent of the difference between Italian and European performance.

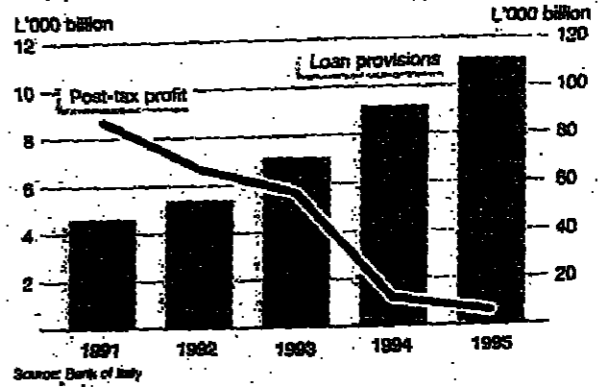
Recent proposals allowing

banks to lay off staff on the state scheme ought to provide some relief: as much as a quarter of bank staff, 333,000 at the end of last year, are surplus to requirements. But ABI emphasises that the tax burden must be reduced in order for the Italian banking system to close the gap with the rest of Europe.

There are important implications for the country's banking system in trends in the corporate sector.

Giovanni Palladino, head of finance at the industrialist's federation Confindustria, says that large and medium-sized companies are becoming increasingly independent of bank credit. "Banks must refocus their services to help companies

Italy's banking system



Source: Bank of Italy

gain access to financial markets and use innovative financial instruments," he says.

Concentration, privatisation, and efficiency are priorities. Satisfying the changing market of corporate busi-

ness is just one more item in the daunting list of crucial adjustments that Italy's banks must now make quickly.

The first half of the 1990s was a period of missed opportunity. The present challenge is awesome.

Exports and currencies by Robert Graham

Unique cycle is over

ERM re-entry signals an end to the era of competitive devaluation

For the fourth successive year Italy looks set to enjoy a record trade surplus. On present projections, based on eight months' figures, the surplus should be about L50,000bn.

At current prices this will be more than three times the level back in 1993, the first year which saw the benefits of a sharply devalued lira. However, circumstances have changed radically since the lira was left to float free after being forced from the European Exchange Rate Mechanism (ERM) during the September 1992 currency crisis.

The era of a competitively devalued lira - so unpopular with Italy's European Union partners - is ending. Last Sunday's decision to bring the lira back inside the ERM was an essential step on the path towards taking part in the single European currency, one objective of Mr Romano Prodi's centre-left government.

There are many hurdles along this route, the most serious being the country's ability to comply with the convergence criteria on the rate of inflation, the size of the budget deficit and the level of Italy's debt stock.

Nevertheless, the objective of monetary union is backed by all the main political parties as well as by trades unions and the business community. With 56 per cent of all trade within the EU, a lot is at stake in once again seeking to discipline the lira to fixed bands.

The government always hoped to have completed the re-entry negotiations by the end of November, once the 1997 budget passed through the chamber of deputies. The objective was achieved only after hard bargaining with its EU partners over an acceptable parity for the Italian currency, eventually fixed at L990 to the D-Mark.

The lira has gained 10 per cent this year as the country's economic fundamentals have improved and has been hovering around L1,000 against the D-Mark since the summer. It would have strengthened more had not the Bank of Italy intervened heavily on occasions to prevent further appreciation. This was an indication that the Italian authorities were seeking re-entry around this central parity.

In the run-up to the decision, Confindustria, the industrialists' federation, said L1,000 against the D-Mark was the maximum acceptable. Exporters - and notably big groups such as Fiat - would have preferred to fix the lira at the L1,050 level. Few have forgotten the difficulties they faced in 1992 when the Bank of Italy persisted until the last with a strong lira policy.

A recent study by Milan's Bocconi University showed that on next year's macro-economic projections, operating margins would be little affected with the lira at L1,050. At a parity of L950, however, the negative impact would be significant. Margins in the white goods industry, for instance, would be down almost 4 per cent; in clothing by nearly 3 per cent and machinery by more than 3 per cent.

France and Germany account for 54 per cent of Italy's exports to the EU and since 1993 have felt the most vulnerable to the impact of a cheap lira. However, the French government has been the more vocal in attacking the competitive advantage enjoyed by Italian compa-

nies, and, ahead of Sunday's decision, was the toughest in insisting on a parity around or below L950.

Germany, conscious that it would have to bear the cost of defending an overvalued lira, seemed prepared to accept a more realistic parity. In any event, bridging the gap between the interests of exporters and accommodating the French and Germans has proved no easy task for the government.

While devaluation was undoubtedly the catalyst for swinging the trade balance from deficit to surplus in 1993, at least four other elements have contributed to the extraordinary export performance:

- Over the past four years, the rhythm of domestic demand has slowed as public spending has been cut in real terms and consumer spending has been depressed;
- As a result of the 1993 wage pact between the government, unions and employees, pay has been de-indexed and linked to productivity. This has led for the first time in three decades to wages increasing below the rate of inflation;
- Fear of job losses has led to an unprecedented stability on the shop floor;
- Inflation, despite some blips, has been falling and there has been relatively little imported inflation from increased raw material costs.

However, the cycle of this unique combination of circumstances is over. Last year was the high point, when Italy's trade surplus soared to L44,000bn from L24,000bn. Not only was this when the lira reached its weakest point (almost L1,200

against the D-Mark), but also companies benefited from special tax privileges in the so-called Tremonti Law.

This law, formulated by the Berlusconi government in the 1995 budget, allowed companies big tax breaks for re-investing profits. This encouraged expansion and was so popular that the Dini government was obliged to prolong its application into part of this year.

The effects of the Tremonti Law have now been exhausted. Added to this, Italy's main export markets in the EU are performing poorly.

In the first seven months, overall exports grew 3.8 per cent compared to 25 per cent during the same period the previous year.

If the August figures are included, average export growth had dropped even lower, to 2.4 per cent, while imports were down 2.1 per cent. In Germany, which accounts for 17 per cent of Italian exports, sales were down by 1.2 per cent.

Another important change is a rise this year in production costs and a potentially

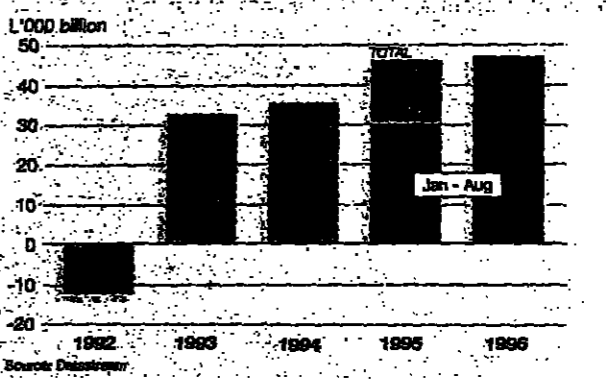
inflationary wage settlement which would permit employees in key sectors to recoup a large part of earnings lost through inflation since 1994.

In Confindustria's latest economic bulletin, labour costs were up 7.3 per cent this year and it estimated that wage costs could increase 18 per cent in the period 1996-98 if current union claims were met in full. Also on the horizon is the impact of more costly imported energy. Compared to the onset of last winter, fuel prices are well up.

Most businesses have built up enough fat to allow them to reduce their margins and ride out a difficult 1997. But next year will be a testing time, especially with the lira's central ERM parity below L1,000.

Much attention will focus on businesses in the north-east which has been regarded as a "miracle" growth area since the start of the nineties. Critics have argued that its small companies, operating in niche markets, have prospered almost exclusively on the back of a cheap lira.

Visible trade balance



Source: Dolciener

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The stock exchange: by Andrew Hill

Time to solve problems

Efforts to improve the market's international image have been undermined

Italy's stock exchange authorities have long worried about how to make their market more liquid, improve transparency and overcome a marked reluctance on the part of Italy's dynamic family-owned small and medium-sized companies to tap the stock market for funding.

Now they face another challenge which makes finding a solution to these perennial difficulties even more pressing: it is called Eurosim; the Italian law which implements the European Union's investment services directive.

The Eurosim replaces the old Sim law - named after the type of local securities houses (*Società di Intermediazione Mobiliare*) which it set up. The Sim law provided a measure of protection for local intermediaries and was ruled illegal by the European Court of Justice earlier this year for discriminating against foreign banks and brokers.

The investment services directive, by contrast, opens the way to head-to-head competition between European stock exchanges and intermediaries. Brokers can now trade by remote links on the same terms as local Sims.

The floors of Italy's 10 stock exchanges - merged under one Milan-based stock-exchange council - are deserted and the battle is on to

attract computerised dealers from around Europe. Eurosim will also transform the old stock exchange into a self-regulating joint stock company, owned by the intermediaries, including banks, cleared by the new laws to trade directly on the equity markets.

Long-established brokers are worried that they may be crushed by the banks. But Mr Franco Cesarini, head of the Italian stock exchange council since March and chairman of Banca Popolare di Milano, one of Italy's biggest banks, says there will be a role for both types of intermediary, and the entry of the banks will benefit all users of the market.

"As far as the retail market is concerned, the banks are an extremely important channel for savings, but the banks are above all important for the way in which their contacts with companies can generate new applications [for listing] and new quoted stocks," he said in a recent interview. This goes to the heart of the Italian

stock exchange's problem. It is small by comparison with the Group of Seven-sized economy; still overweight in financial and holding companies, and clogged by illiquid stocks.

The Italian government's slow-moving privatisation programme and incentives for small and medium-sized companies to float on the stock exchange, have reinforced the *borsa* in the past two years.

In 1995, 14 new companies were admitted to the *borsa* and this year 12 new stocks have been listed (including Mediolanum, the insurance and financial services group, and Mediasset, the media company, both controlled by Mr Silvio Berlusconi, former prime minister). At least four others are expected to float before the end of the year.

That is still small beer, however, compared with the estimated pool of 1,500 unquoted manufacturing companies which fulfil the minimum requirements for a listing. Added to which,

while the stock exchange authorities have pushed ahead with modernisation, the principles of good corporate governance are still a mystery for many of Italy's larger quoted companies.

Within the past year, scandals at Gemina - the investment company controlled by some of Italy's best-known corporate names - and a rash of ill-explained problems at Olivetti, the information technology group, have undermined efforts to project a new, more transparent image for the Italian market internationally.

Mr Cesarini's hope is that Milan will be able to fight off competition by becoming even more efficient and user-friendly. In January, for example, the exchange expects to open a computer node in London linking the City directly to the Milan computer trading system.

Eventually, the exchange authorities believe, three divisions of Italian quoted companies will develop: a first tier of between 30 and 50 blue-chip stocks, including the best-known international companies such as Fiat, Pirelli and Generali; a second tier of "domestic" stocks, which would take in many of the attractive newly-quoted medium-sized companies; and a third division



Milan's stock exchange before computerised trading; the floors of Italy's 10 stock exchanges are now deserted

Mr Luciano Balbo, chairman of B&S Electra, a Milan-based venture capital company part-owned by Electra Fleming.

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of less liquid stocks, which might be traded once or twice a week in a special session.

Meanwhile, the much-discussed plan for a small sec-ond market - with less stringent listing requirements than the main market - seems to have been quietly put aside.

"We already have a *borsa* for small and medium-sized companies," says one ven-

ture capitalist. "It's the Milan stock exchange." Mr Cesarini and his colleagues hope that, in the face of international competition, they can win themselves a more exalted reputation.



Cesarini hopes Milan will be more efficient and user-friendly



Fazio attacked families which dominate leading companies

INTERVIEW

Giorgio Fossa, chairman of Confindustria

Obligated to tackle politics

One of the most persistent criticisms levelled against Confindustria, the industrialists' confederation, is that it has defended the interests of big business at the expense of small companies.

In good measure, Mr Giorgio Fossa, who took over the chairmanship of Confindustria in May, owed his election to a feeling among members that this imbalance needed addressing.

This was even the case of Fiat, Italy's largest private group, which openly backed Mr Fossa's candidature.

For almost a decade he has been championing small businesses inside Confindustria. "Small- and medium-sized companies represent over 90 per cent of the membership," he says.

"Governments always talk about doing something for them during the elections, then they are quietly forgotten."

He insists that the model of the small family company is far from being outmoded. With flexible structures, mostly non-unionised labour and innovative dynamism, Mr Fossa regards the family concern as still the backbone of the economy.

"Foreigners do not come to Italy to study our

government structures, or our privatisation but they do come to study the success of small and medium businesses."

Mr Fossa, 42, is the third generation of a Varese industrial family active in specialised engineering. The business, Silvio Fossa, employs 70 people and designs, produces and assembles various types of cylinders.

Despite his desire to focus on the problems of small businesses - from labour costs, to scarce credit and excessive state bureaucracy - he has been obliged to field more political problems from the outset.

Confindustria is still playing a bigger political role than he believes it should, because of the vacuum created by a weak government and divided political parties.

He has to represent industrialists at a time when domestic demand has not looked so bleak for more than two decades.

In an interview before Sunday's election to entry to the Exchange Rate Mechanism (ERM), he was adamant that the lira should not re-enter the ERM at anything stronger than L1,000 against the D-Mark and he would have preferred it closer to L1,050. The central rate agreed on

Sunday was 1,900.

Secondly, he has found himself weighing in with a forceful Confindustria view on the 1997 budget, the government's slowness to privatise and the lack of a clear political will to introduce more flexible working practices.

Confindustria is concerned that the centre-left government is storing up problems by failing to address the issue of how to cut public spending on health and pensions in the 1997 budget.

Mr Fossa himself is worried that growth next year will be weak after near-stagnation this year,



Fossa: he insists the model of the small family company is far from being outmoded

with negative consequences for jobs. In this climate, insufficient thought is being given to the cost of employment born by companies.

Employers, he says, cannot be expected to create jobs when the overheads are so high. "People must realise, the more rigid the labour market the less jobs created," he says. Like many employers he now cites the UK example of flexible labour markets as a model.

"In the UK, part-time accounts for 25 per cent of employment; in Italy it is only 6-7 per cent. In the UK, a worker works an average 1,900 hours a year against 1,600 in Italy; and as for non-wage costs these represent only 10 per cent in the UK, compared to nearly 50 per cent in Italy."

More progress on labour flexibility might have been made in negotiations with the unions had not the climate been conditioned by a series of important wage negotiations.

This year, the 1993 agreement between government, employers and unions on wage and work conditions came up for review. The agreement has been crucial for ensuring stability on the shop floor and in holding down wages below inflation. But the

1993 pact envisaged a revision after two years which allowed the unions to recover, at least in part, earnings eroded by inflation.

Engineering workers, traditionally the barometer of wage settlements, are currently locked in a bitter confrontation with employers over a renewal of their national contract. The employers are conceding only a minimal catch-up payment while the unions are insisting upon recouping the bulk of what they have lost through inflation.

At a time of squeezed margins and slack demand, Confindustria says it cannot afford to meet the engineering workers' claim. The Bank of Italy has warned that the settlement risks being inflationary.

There are 14 other big sectoral wage claims in the pipelines. But the outcome of this confrontation will determine the climate of industrial relations for the foreseeable future.

Mr Fossa appears reasonably confident of a solution. The employers' hand could be helped by the stagnant state of domestic demand which might frighten the unions into moderating their claims.

Robert Graham

PROFILE Pier Luigi Bersani, industry minister

Honeymoon period comes to an end

Until September, Pier Luigi Bersani was enjoying a fairly calm honeymoon period as Italy's new industry minister. In the first four months in the job, his public declarations tended to touch on broad economic themes, regulation of energy and telecoms, and forthcoming privatisations; nothing too controversial.

Recently, however, the new minister has had to handle some of the country's most sensitive industrial issues.

The minister's opinion has been sought on events ranging from September's surprise arrest of Mr Lorenzo Necci, the chairman of the state railway - a move which seemed to call into question one of the country's biggest infrastructure investment programmes - to this month's ambitious government plan to merge the state-controlled telecoms companies and end the dominance of Iri, the state holding company, over Italy's industrial economy.

All this has come against a background of sluggish consumption and a strengthening lira, and difficult negotiations - still open at the time of going to press - with engineering workers.

Mr Bersani is only 45 but a veteran of regional politics with the former communist PDS, the largest party in the government coalition. Before Mr Romano Prodi, the prime minister, selected him to run the industry ministry, he was president of Emilia-Romagna, Mr Prodi's home region and the cradle of small and medium-sized manufacturing industry.

Mr Bersani himself claims that in the area around his home town, near Piacenza, "one in

every 10 people is an entrepreneur". Under the circumstances, the minister sounds slightly disappointed at industrialists' equivocal reaction to the 1997 budget - a reaction "of light and shade" as he tactfully puts it.

He points out that this government is trying to act on its campaign promises to cut down on unnecessary bureaucracy and encourage the small entrepreneur.

"The latest financial manoeuvre is moving in this direction - and if we get it through, 1997 could be a year of extremely substantial reforms, benefiting companies," he claims.

Furthermore, he says, the new government's economic policy helped push down inflation, prompt the long-awaited cut in interest rates, and encourage an end to volatile currency movements.

As for the accusation that not enough has been done to tackle structural reform of the pension system, Mr Bersani replies that "opening the question of pensions this year would have been a gesture which



Bersani '1997 could be a year of extremely substantial reform'

created more problems than benefits".

With the lira now at its strongest for nearly two years, Mr Bersani sees the ministry's role as encouraging competitiveness through other means, including deregulation of telecoms and electricity to reduce costs for industry; removal of more bureaucratic obstacles; reform of fiscal policy and the banking system; and encouragement of research and development, particularly in those growing areas such as biotechnology and microelectronics where Italy is weak.

As the list indicates, in many areas the industry minister has to work closely with other cabinet colleagues. Shares in the largest state-controlled companies are either directly owned by the treasury or held through Iri (itself treasury-owned), but the industry ministry sometimes regulates the state monopolies - as is the case, for example, with Enel, the state electricity producer.

The sluggish privatisation programme should eventually eliminate that duplication of responsibility. But many quasi-governmental organisations and regulatory instruments for industrial policy are still shared with or controlled by other ministries.

Mr Bersani hopes government plans to simplify ministerial responsibilities will leave the industry ministry with clear responsibility for industrial promotion - a more appropriate and useful role now that the long era of Italian state subsidies and direct intervention seems to be finally drawing to a close.

Andrew Hill

4 ITALY: FINANCE, INDUSTRY AND EXPORTS

Aerospace and defence: by David Lane

Little to laugh about

Uncertainty pervades in a sector suffering weak demand and surplus supply

Australia's decision to award a contract to British Aerospace for 40 Hawk military trainer aircraft earlier this month dealt a heavy blow to Italy's aerospace and defence sector. Aermaochi had supplied Australia with the Hawk's predecessor, the M322, and expected to follow with the M330.

This setback has led some industry insiders to question Aermaochi's viability if it loses forthcoming international battles for trainer orders, in South Africa particularly. Indeed, rationalisation of Italy's aircraft trainer capacity is thought imminent and may not await the outcome of these battles.

Italy's leading aerospace and defence company, Finmeccanica, in which the troubled IRI state holding has a 63.4 per cent stake, owns a 25.5 per cent interest in Aermaochi as well as 99.3 per cent of Siai Marchetti which also makes trainer aircraft. Insiders have described the situation as

messy and lacking clear policy. Uncertainty is a general problem, however, in a sector suffering from weak demand and surplus supply. Several important defence projects have finished in recent years or are running down, while new ones are in early stages. Meanwhile, markets at home and abroad are soft. Improvements on the civil aerospace stage, in which Italy is a bit player rather than a star, are insufficient to compensate.

That the Tornado multi-role combat aircraft, in which Finmeccanica's Alenia is a partner, is no longer a current project is under-

lined by Italy's leasing of 12 air defence variants from Britain, with a further 12 leased aircraft due for delivery next year. Following reduction of planned numbers by one quarter, Alenia's AMX light tactical fighter programme, a joint effort with Brazil, is now complete. Few expect the Future Large Aircraft project to get airborne, and Italy's needs for a large military transport aircraft will probably be met by purchases of Lockheed's C130J. Alenia hopes to benefit from an agreement with Lockheed Martin for developing and selling the C27J, a tactical transport based on

Italy's elderly G222, however.

Many of Alenia's military aircraft hopes are pinned on Eurofighter, a partnership with Britain, Germany and Spain. But the project is at risk until there is commitment to tooling for production: the longer the wait, the greater the risk. Moreover, Italy will probably take many fewer than the 130 currently planned.

The situation is equally bleak in the rotary wing business. With the disappearance of military threat in central and eastern Europe, the requirement for Finmeccanica's Agusta A129 army attack helicopter has evaporated, and so have high expectations for export orders.

Although production of the EH101 three-engined naval helicopter, jointly developed by Agusta and Britain's Westland, is under way, the Italian order for 16 has hit bureaucratic barriers and awaits final approval. The NH90 being developed with France and the Netherlands is still far over the horizon.

There are some rays of light in the civil aircraft sector, however. Finmeccanica noting that the upturn in



Many of Alenia's military aircraft hopes are pinned on Eurofighter, a partnership with Britain, Germany and Spain



The EH101 helicopter, jointly developed by Agusta and Westland

commercial aviation had led to significant improvements in revenues and orders. The ATR commuter aircraft in which Alenia partners France's Aérospatiale has had success, and last year's agreement with British Aerospace to establish Aero

International Regional (AIR) provides a way to build on this. AIR is Italy's only big long-term prospect in civil aircraft. Alenia is outside the Airbus consortium and lacks financial resources to buy a stake. While Alenia works for Boeing and McDonnell Douglas, the US makers are likely to turn increasingly to expanding Far East markets when subcontracting.

Since Europe's political upheavals in 1989 and the recession of the early 1990s, Italy has done too little to bring its aerospace and defence manufacturing capacity into line with orders. Some may be hoping that better times are round the corner.

Yet with Maastricht criteria to meet, the prospects are for even lower defence spending in Europe. Defence budgets are being trimmed in countries further afield, and competition is fierce.

Finmeccanica's aerospace and defence payrolls reflect the failure to tackle the problem of too many workers and not enough work. Between 1994 and 1995, Finmeccanica's aerospace workforce fell by just 2.2 per cent to 21,400, while its defence numbers declined by 3.1 per cent to 9,700. Perhaps as

much as a quarter are surplus to requirements.

Meanwhile the accounts at Finmeccanica, where aerospace represented 92 per cent of revenues last year and defence 17 per cent, reflect the situation. The company made just 140bn net profit in 1995 on 112,844bn revenues; net profit was 152bn in 1994 on revenues of 112,117bn. Separate figures are not available for the aerospace and defence businesses, and IRI, Finmeccanica and Alenia decline to talk about results or prospects. The odds are that the two businesses are heavily loss-making.

Although IRI has a firm controlling stake and Italian public-sector banks are other large shareholders, Finmeccanica is a quoted company. But it is not a share that is closely followed: some Milan analysts describe it as "a joke".

There is however, little to laugh about at Finmeccanica or in Italian aerospace and defence.

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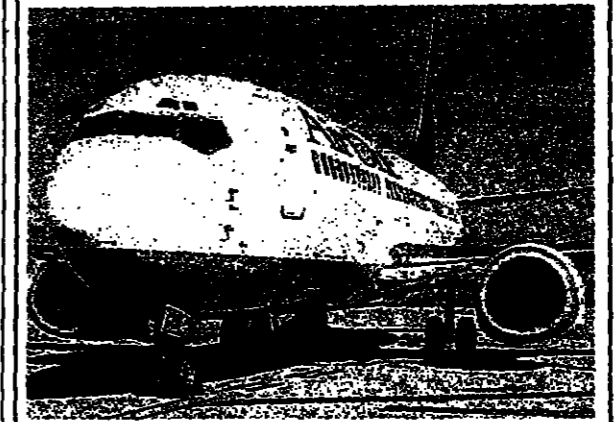
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ITALY'S LEADING PRIVATE BANK



The airlines



Air One woo passengers with daily papers and sweets

Competition gets fierce

The deregulation of Italy's airlines in 1993, setting internal flights on track to full liberalisation by 1997, has cost the flag carrier Alitalia its privileged monopoly position. Private companies are increasingly making their presence felt on scheduled flights as the deregulation measures are gradually implemented.

There is competition among the various carriers on all national routes but it is fiercest on the Milan-Rome stretch. Alitalia, however, has shown that it is not outmanoeuvred by its new rivals and offers prices on its route between Milan's Linate airport and Fiumicino, Rome, between 199,000 and 1230,000. It remained easily the biggest operator between Milan and the capital last year, with 1.654m passengers.

Chief among its rivals is Air One, owned by Mr Carlo Tota, the Abruzzo businessman, which began operations in November 1995. In the first nine months of 1996, with 13 flights a day in each direction, it carried 345,000 passengers. A one-way Air One ticket between Linate and Fiumicino costs between 160,000 and 1180,000.

In the same nine months, Noman, 51 per cent owned by the La Starza family and 49 per cent by Italian Technic, carried 80,000 passengers between Linate and Rome's Ciampino airport, paying between 194,000 and 1164,000. The airline, which began

business at the end of last year, provides six flights a day in each direction.

The longer-established Meridiana, meanwhile, jointly owned by the Aga Khan, AirIn, Flanpar and Cariplo, the Milan-based savings banks, carried 145,000 passengers in the whole of 1995 between Fiumicino and Milan's Malpensa airport, with three flights a day in each direction. Tickets cost between 1161,000 and 1230,000. The company is also active on other routes and carried a total of 2.197m passengers last year.

Recently, Alpi Eagles, which is based in the Veneto, in north-east Italy, and is owned by a business consortium including Stefanel, Zanussi and Marzotto, concluded a collaboration deal with Alitalia on some routes - but not between Venice and Rome where annual traffic totals 700,000 passengers and where the two companies remain in competition. Alpi Eagles prices are between 14.5 per cent and 35 per cent cheaper than those of its flag carrier rival.

However, price is not the only yardstick of competition. Although Alitalia has improved its on-board service on the Milan-Rome flights, it is outshone by Air One, for example, which has sought to woo passengers with daily papers and sweets and serves a continental breakfast or afternoon snacks and drinks.

Luisella Carenzio

CURRENCIES AND MONEY

Lira stable after Italy's ERM return

MARKETS REPORT By Simon Kuper

The lira gained on its first day back in the European exchange rate mechanism since September 1992, closing just above its new central parity rate of 1990 against the D-Mark.

The parity rate, set by European Union ministers and central bank officials in late night talks on Sunday, surprised the markets, which had gambled on a parity of 1:1,000. Traders holding lira that had bought before the weekend made money on the difference.

The lira's re-entry dominated trading, which was thin because of US holidays later this week. Traders are now more confident than before that Italy will participate in the first stage of European monetary union.

The dollar closed in London 1.7 pence higher at DM1.519, while the pound rose by the same amount to DM2.542. The dollar rose 0.8 cents against the pound to \$1.672.

Italy's re-entry also helped send the dollar soaring against the yen. The US currency closed Y1.3 higher at Y111.2.

The French franc recovered somewhat from recent losses against the D-Mark, closing at FF4.384. This is because Italy's re-entry into the ERM at a stronger rate than expected was seen to reduce pressure on Paris to devalue the franc.

Currency strategists said yesterday that they were confident Italy could maintain the lira at around its new central parity for the following months.

But the strategists said Italy may not be able to sustain the lira within a 2.25 per cent fluctuation band against the D-Mark for the next two years. If Italy cannot, its chances of joining EMU at the first stage may recede further.

Now that Italy has entered the ERM at a stronger rate than expected, the threat to the French economy from the lira has diminished.

Yesterday a host of French politicians and Bank of France officials, led by Mr Jean Arthuis, finance minister, restated their support for the franc fort, a policy criticised last week by politicians including former president Mr Valéry Giscard d'Estaing.

Cuts in personal income tax aimed at winning votes for the ruling Conservative party ahead of the election expected next spring could further stimulate consumer spending.

Mr Kenneth Clarke, the UK chancellor, presents the UK's annual budget today. If he unveils a tax-cutting Budget which puts upward pressure on interest rates, he could further fuel the pound's recent rally.



Mr Steven Egan, International economist at Smith Barney in Paris, said: "My mother could keep a currency within a 15 per cent band."

The Paris government's franc fort policy looks more likely to survive now than it did at times last week. France has long been concerned about the weak lira, which has made Italian exports more competitive relative to its own products.

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WORLD INTEREST RATES

Table of Money Rates for various countries including Belgium, Germany, France, Italy, Netherlands, Switzerland, and Japan. Columns include Over night, One month, Three months, Six months, One year, Lomb. Int., and Repo rate.

EURO CURRENCY INTEREST RATES

Table of Euro Currency Interest Rates for various currencies including Belgian Franc, Danish Krone, Dutch Guilder, French Franc, Portuguese Escudo, Spanish Peseta, and Sterling. Columns include Short term, 7 days, One month, Three months, Six months, and One year.

POUND SPOT FORWARD AGAINST THE POUND

Table of Pound Spot Forward rates for various countries including Europe, Americas, Pacific/Middle East/Africa, and Asia. Columns include Closing mid-point, Change, Bid/offer spread, and various forward rates.

DOLLAR SPOT FORWARD AGAINST THE DOLLAR

Table of Dollar Spot Forward rates for various countries including Europe, Americas, Pacific/Middle East/Africa, and Asia. Columns include Closing mid-point, Change, Bid/offer spread, and various forward rates.

THREE MONTH EURO CURRENCY FUTURES

Table of Three Month Euro Currency Futures for various currencies including Dec, Mar, and Jun. Columns include Open, Set price, Change, High, Low, Est. vol, and Open Int.

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Table of Three Month Euro Currency Futures for various currencies including Dec, Mar, and Jun. Columns include Open, Set price, Change, High, Low, Est. vol, and Open Int.

CROSS RATES AND DERIVATIVES

Table of Exchange Cross Rates for various currencies including Belgium, Denmark, France, Germany, Ireland, Italy, Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, UK, Canada, and US.

JAPANESE YEN FUTURES

Table of Japanese Yen Futures for Dec, Mar, and Jun. Columns include Open, Latest, Change, High, Low, Est. vol, and Open Int.

SWISS FRANC FUTURES

Table of Swiss Franc Futures for Dec, Mar, and Jun. Columns include Open, Latest, Change, High, Low, Est. vol, and Open Int.

STERLING FUTURES

Table of Sterling Futures for Dec, Mar, and Jun. Columns include Open, Latest, Change, High, Low, Est. vol, and Open Int.

UK INTEREST RATES

Table of UK Interest Rates for various terms including London Money Rates and UK clearing bank base lending rates.

EMU CURRENCY UNIT RATES

Table of EMU Currency Unit Rates for various currencies including Ireland, Portugal, Spain, Finland, Netherlands, Belgium, Germany, Austria, Italy, Denmark, and France.

NON-ERM MEMBERS

Table of Non-ERM Members including Greece, UK, and other currencies.

THREE MONTH EURO CURRENCY FUTURES

Table of Three Month Euro Currency Futures for various currencies including Dec, Mar, and Jun.

BASE LENDING RATES

Table of Base Lending Rates for various banks including Adams & Company, Allied Irish Bank, Allied Trust Bank, etc.

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SHORT-TERM EURO CURRENCY FUTURES

Table of Short-term Euro Currency Futures for various currencies including Dec, Mar, and Jun.

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COMMODITIES AND AGRICULTURE

Consortium to buy Port Kembla smelter

By Kenneth Gooding, Mining Correspondent

A Japanese consortium is to buy the Port Kembla copper smelter in New South Wales from RTZ-CRA and will refurbish and expand it at a cost of A\$350m (US\$203m).

down at the end of 1994 because the consortium that owned it then - led by CRA, the Australian mining group, and including Furukawa - was reluctant to spend the cash required to meet increasingly stringent environmental standards.

Furukawa had owned 30 per cent of the Port Kembla smelter but sold out to CRA in June 1995 so the Australian group could close the plant and, possibly, rehabilitate the site.

1990s the consortium spent A\$150m to double capacity at Port Kembla. Furukawa has for some time been hoping to re-open Port Kembla but has been insisting it must have a majority stake. It said yesterday it would have 50 per cent.

Port Kembla, in the southern NSW town of Wollongong, employed 440 before it was closed. Mr Bob Carr, premier of New South Wales, said yesterday that 360 jobs would be created during the construction stage and 270 once the smelter was in operation.

Iraq export move hits oil

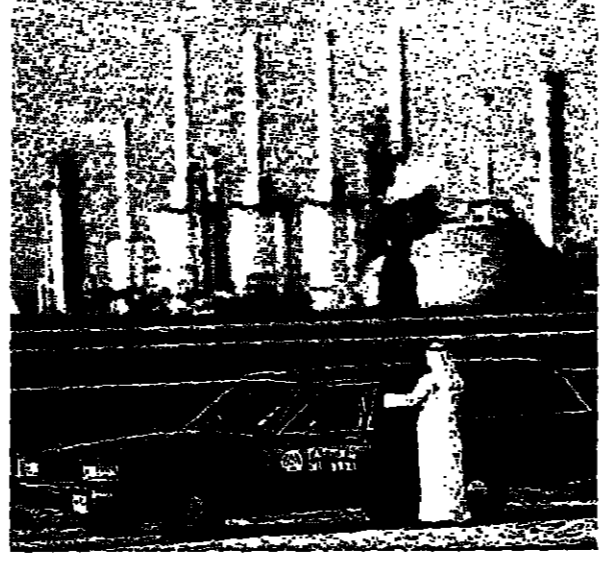
By Peter John and Kenneth Gooding

Oil prices fell yesterday on the news that Iraq may soon be able to export again after agreeing all the conditions of an oil-for-food deal.

designed to deter speculators causing more problems in a copper market already suffering from a severe shortage of metal for immediate delivery.

Quotas back on Opec agenda

Oil ministers from the Organisation of Petroleum Exporting Countries who gather in Vienna tomorrow for their winter meeting must be musing about the old agenda that sometimes the best course of action is to take no action at all.



Opec's 'do nothing' strategy may be challenged in Vienna

be tempted back into the bad old ways of trying to fine-tune supplies. "The market says it wants more oil and it will buy it from anyone willing to produce it," notes Mr Joe Stanislaw at Cambridge Energy Resource Associates in Paris.

COMMODITIES NEWS DIGEST

Jamaican bauxite refiners to expand

Jamaica's bauxite refiners plan to spend about \$500m over the next five years to expand their plants and lift national capacity from 3.4m tonnes a year to just over 6m tonnes.

Hyundai team targets nickel

A consortium led by Hyundai, the Korean industrial group, wants to acquire a 15 per cent stake in the A\$300m (US\$173m) Murrumbidgee nickel-cobalt project in Western Australia being pursued by Anaconda Nickel, the Australian-listed miner.

Normandy sells Bounty stake

Normandy Mining, Australia's largest gold producer, is selling its 62 per cent interest in the Bounty gold mine in Western Australia to Forrestania Gold, a smaller Perth-based miner, for around A\$40m (US\$25.4m).

COMMODITIES PRICES

Table containing Base Metals, Precious Metals, and LONDON METAL EXCHANGE prices. Columns include item names, prices, and changes.

Table containing Grains and Oil Seeds, SOFTS, and MEAT AND LIVESTOCK prices. Columns include item names, prices, and changes.

Table containing SOYABEAN OIL CME, WHITE SUGAR LIFE, and COFFEE (C) prices. Columns include item names, prices, and changes.

Table containing COFFEE (C) prices, COFFEE (C) prices, and COFFEE (C) prices. Columns include item names, prices, and changes.

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JOTTER PAD

A jigsaw puzzle advertisement for 'SIDDHART' with a grid and instructions. Text includes 'The game of Skill, Judgement and Nerve' and 'Telephone 07000 782080'.

CROSSWORD

A crossword puzzle grid with clues. Text includes 'No.9.235 Set by PHSSHPK' and a list of clues for both Across and Down directions.

PRECIOUS METALS

Table with 2 columns: Item Name and Price. Includes Gold, Silver, and Platinum.

LONDON BULLION MARKET

Table with 2 columns: Item Name and Price. Includes Gold, Silver, and Platinum.

NATURAL GAS NYMEX

Table with 2 columns: Item Name and Price. Includes Natural Gas NYMEX.

UNLEADED GASOLINE

Table with 2 columns: Item Name and Price. Includes Unleaded Gasoline.

FUTURES DATA

Table with 2 columns: Item Name and Price. Includes various futures contracts.

VOLUME DATA

Table with 2 columns: Item Name and Volume. Includes various futures contracts.

INDICES

Table with 2 columns: Item Name and Index Value. Includes various market indices.

FT MANAGED FUNDS SERVICE

OFFSHORE AND OVERSEAS

BERMUDA (SIB RECOGNISED)

Table listing various offshore funds under the Bermuda (SIB RECOGNISED) category, including fund names, managers, and performance metrics.

BERMUDA (REGULATED)**

Table listing various offshore funds under the Bermuda (REGULATED)** category.

GUERNSEY (SIB RECOGNISED)

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ROYAL BANK OF CANADA

Table listing various funds managed by the Royal Bank of Canada.

IRELAND (SIB RECOGNISED)

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Table listing various funds managed in the Isle of Man (REGULATED**).

ISLE OF MAN (SIB RECOGNISED)

Table listing various funds managed in the Isle of Man (SIB RECOGNISED).

Advertisement for MINI REUTERS MAXIMUM ADVANTAGE, featuring a handheld device and text describing its benefits for financial news.

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FT MANAGED FUNDS SERVICE

Offshore Funds and Insurances

FT Cityline Unit Trust Prices are available over the telephone. Call the FT Cityline Help Desk on (+44 171) 873 4378 for more details.

LUXEMBOURG (SIB RECOGNISED)

Table listing various Luxembourg funds including ASM Alpha Funds, Abroad Fund, and others, with columns for fund name, currency, and price.

Table listing various Luxembourg funds including Muzary Asset Management, Mifond Global, and others, with columns for fund name, currency, and price.

Table listing various Luxembourg funds including Credit Investment Funds, Mifond Global, and others, with columns for fund name, currency, and price.

Table listing various Luxembourg funds including Southern International, Mifond Global, and others, with columns for fund name, currency, and price.

LUXEMBOURG (REGULATED)

Table listing regulated Luxembourg funds including Mifond Global, and others, with columns for fund name, currency, and price.

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LUXEMBOURG (REGULATED)

Table listing regulated Luxembourg funds including Mifond Global, and others, with columns for fund name, currency, and price.

OFFSHORE INSURANCES

Table listing various offshore insurance policies including AXA Equity & Low Cost Life, and others, with columns for policy name, currency, and price.

FT MANAGED FUNDS SERVICE

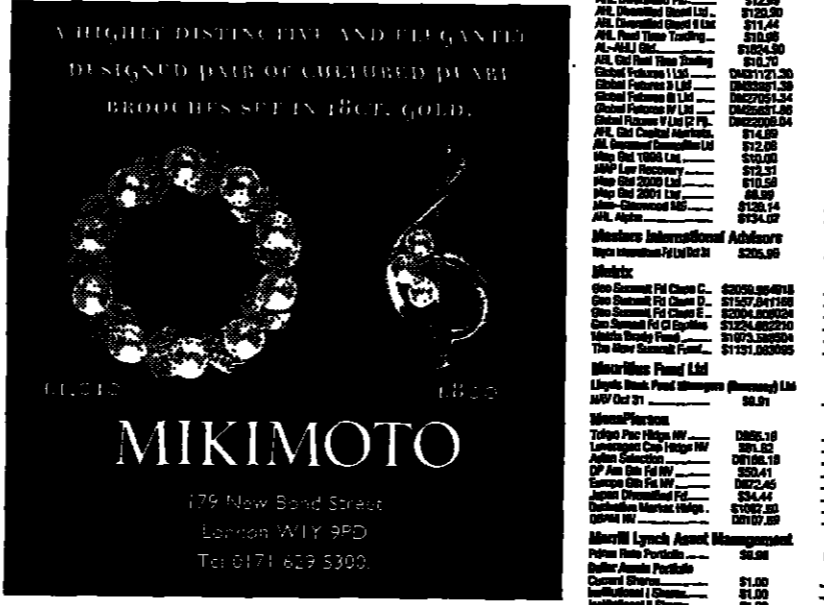
Offshore Insurances and Other Funds

FT Cityline Unit Trust Prices are available over the telephone. Call the FT Cityline Help Desk on (444 177) 873 4378 for more details.

Table of FT Managed Funds Service listing various fund categories such as Global Asset Management, UK Equity, and UK Fixed Income. Includes columns for fund name, price, and performance metrics.

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OTHER OFFSHORE FUNDS

Additional information and notes regarding the fund listings, including contact details and disclaimers.

LONDON SHARE SERVICE

ALCOHOLIC BEVERAGES

Table listing companies in the Alcoholic Beverages sector with columns for company name, price, and change.

BANKS, MERCHANT

Table listing companies in the Banks, Merchant sector.

BANKS, RETAIL

Table listing companies in the Banks, Retail sector.

BREWERIES, PUBS & REST

Table listing companies in the Breweries, Pubs & Rest sector.

BUILDING & CONSTRUCTION

Table listing companies in the Building & Construction sector.

BUILDING MATS. & MERCHANTS

Table listing companies in the Building Mats. & Merchants sector.

CHEMICALS

Table listing companies in the Chemicals sector.

CHEMICALS - Cont.

Continuation of Chemicals sector table.

DISTRIBUTORS

Table listing companies in the Distributors sector.

DIVERSIFIED INDUSTRIALS

Table listing companies in the Diversified Industrials sector.

ELECTRICITY

Table listing companies in the Electricity sector.

ELECTRONIC & ELECTRICAL EQPT

Table listing companies in the Electronic & Electrical Eqpt sector.

ENGINEERING

Table listing companies in the Engineering sector.

ENGINEERING, VEHICLES

Table listing companies in the Engineering, Vehicles sector.

EXTRACTIVE INDUSTRIES

Table listing companies in the Extractive Industries sector.

EXTRACTIVE INDUSTRIES - Cont.

Continuation of Extractive Industries sector table.

FOOD PRODUCERS

Table listing companies in the Food Producers sector.

FOOD PRODUCERS - Cont.

Continuation of Food Producers sector table.

GAS DISTRIBUTION

Table listing companies in the Gas Distribution sector.

HEALTH CARE

Table listing companies in the Health Care sector.

HOUSEHOLD GOODS

Table listing companies in the Household Goods sector.

ENGINEERING

Table listing companies in the Engineering sector.

EXTRACTIVE INDUSTRIES - Cont.

Continuation of Extractive Industries sector table.

FOOD PRODUCERS

Table listing companies in the Food Producers sector.

HOUSEHOLD GOODS - Cont.

Continuation of Household Goods sector table.

INSURANCE

Table listing companies in the Insurance sector.

INVESTMENT TRUSTS

Table listing companies in the Investment Trusts sector.

INVESTMENT TRUSTS - Cont.

Continuation of Investment Trusts sector table.

INVESTMENT TRUSTS

Table listing companies in the Investment Trusts sector.

INVESTMENT TRUSTS SPLIT CAPITAL

Table listing companies in the Investment Trusts Split Capital sector.

ENGINEERING

Table listing companies in the Engineering sector.

EXTRACTIVE INDUSTRIES - Cont.

Continuation of Extractive Industries sector table.

FOOD PRODUCERS

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INVESTMENT TRUSTS SPLIT CAPITAL

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INVESTMENT TRUSTS

Table listing companies in the Investment Trusts sector.

Advertisement for Mezzo restaurant, 100 Wardour Street, London, W1. 0171 314 4000. Business Lunch Monday to Friday, Two courses £16.50, Three courses £19.50. Sunday Brunch, Three courses from £14.50. (12.5% discretionary service charge will be added)

LONDON SHARE SERVICE

BUY TRUSTS SPLIT CAPITAL - Cont.

Table listing Buy Trusts Split Capital with columns for Name, Price, and other financial metrics.

OTHER INVESTMENT TRUSTS

Table listing Other Investment Trusts with columns for Name, Price, and other financial metrics.

INVESTMENT COMPANIES

Table listing Investment Companies with columns for Name, Price, and other financial metrics.

LEISURE & HOTELS

Table listing Leisure & Hotels with columns for Name, Price, and other financial metrics.

PAPER, PACKAGING & PRINTING - Cont.

Table listing Paper, Packaging & Printing companies.

PHARMACEUTICALS

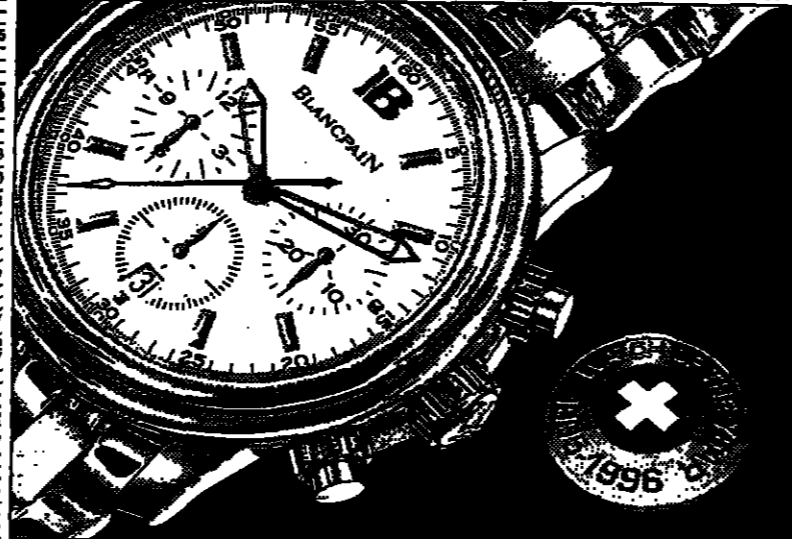
Table listing Pharmaceutical companies.

PROPERTY

Table listing Property companies.

SUPPORT SERVICES

Table listing Support Services companies.



PROPERTY - Cont.

Table listing Property companies (continued).

SUPPORT SERVICES - Cont.

Table listing Support Services companies (continued).

RETAILERS, FOOD

Table listing Retailers & Food companies.

TELECOMMUNICATIONS

Table listing Telecommunications companies.

TEXTILES & APPAREL

Table listing Textiles & Apparel companies.

AMERICANS

Table listing American companies.

TOBACCO

Table listing Tobacco companies.

TRANSPORT

Table listing Transport companies.

CANADIANS

Table listing Canadian companies.

SOUTH AFRICANS

Table listing South African companies.

WATER

Table listing Water companies.

AIM

Table listing AIM (Alternative Investment Market) companies.

RETAILERS, FOOD - Cont.

Table listing Retailers & Food companies (continued).

PAPER, PACKAGING & PRINTING

Table listing Paper, Packaging & Printing companies.

GUIDE TO LONDON SHARE SERVICE

Guide to London Share Service: Details on how to use the service, including information on data sources, updates, and contact details.

LONDON STOCK EXCHANGE

Budget optimism sees Footsie race higher

MARKETS REPORT
By Steve Thompson,
UK Stock Market Editor

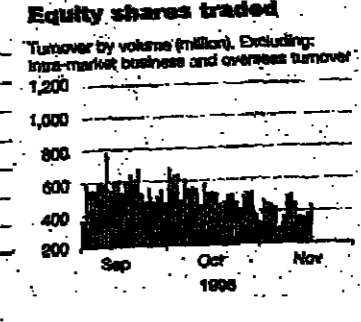
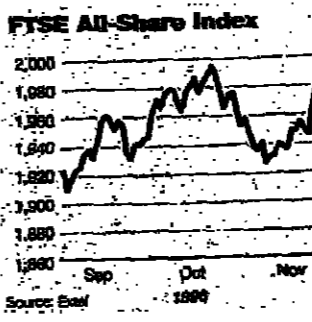
Having blasted back through the 4,000 level on Friday, the FTSE 100 index took a determined, although ultimately unsuccessful, dash at its all-time record yesterday, focusing on the probable benefits to stock market sentiment from the expected prudent Budget today.

past two sessions, Footsie has risen a massive 100.8 points, or 2.5 per cent. At its best yesterday, the index touched 4,053.3. And as happened last Friday, London's marketmakers were on the receiving end of more aggressive buying interest from local and overseas investors anxious to top up their portfolios ahead of the Budget.

"The burst of institutional money flooding into the market caught dealers on the wrong foot and caused a short term bout of panic buying," he said. The FTSE 250 index saw some strong gains across the second line stocks and finished the session 11.0 mtr at 4,423.3. The 250 reached a session high of 4,426.1 in mid-morning. The SmallCap index, meanwhile, gave a resolute performance, closing 2.3 higher at 2,165.3.

As usual during recent sessions, London was given a fillip from across the Atlantic, where Wall Street extended its recent run of gains. The Dow Jones Industrial Average, up over 53 points on Friday, when the index consolidated its move above 6,400, shot through the 6,500 level shortly after the opening yesterday, posting a 40-point plus gain an hour after London closed.

There are fears, however, that there will be increases in taxes on tobacco and alcohol. Turnover reached 775.7m shares at the 6pm count, with non-FTSE 100 stocks accounting for just over 55 per cent of the total. Customer business on Friday, when the market raced higher in response to the emergence of some heavy buying interest, totalled £1.51bn, well above recent levels.



Indices and ratios table with columns for Index Name, Current Value, Change, and Ratio.

Best performing sectors and Worst performing sectors table with columns for Sector Name and Change.

Iraqi concerns hit oils

Leading oil stocks experienced a sharp downturn in afternoon trading, as news broke that Iraq has agreed terms that will allow it to export oil again.

The Iraqi UN ambassador Mr Nizar Hamdoun said Baghdad had agreed to all UN conditions that had held up implementation of an "oil-for-food" deal, and he predicted oil could start flowing sometime in December.

18 1/2 earlier, closed 1/4 off at 577 1/2. BP ended a net 4 1/2 off at 62 1/2 and Shell Transport 1 1/2 weaker at 99 1/2.

Glaxo Wellcome, down 5 per cent from its early October peak as investors worried about the effect of strengthening sterling on the profits of big dollar earners, recovered 2 1/2 to 100 1/2.

Market hopes of a freeze or a cut in excise duties on alcohol gave a boost to several stocks in the sector. A report from HSBC Markets said that cuts in alcohol duty would boost the government's popularity and could give inflation "a vital downward nudge".

Guinness, with a large spirits portfolio, rose 10 1/4 to 457 1/2 on such speculation, coupled with favourable weekend press comment on the stock. Bass, the UK's largest brewer, rose 7 1/2 to 81 1/4 on hopes of a cut in excise duty on beer as well as talk that a ruling is expected shortly on its proposed acquisition of the majority of Carlsberg-Tetley. Whitbread rose 4 to 76 1/4 with NatWest Securities reiterating its "add" stance and emphasising the earnings momentum coming from Whitbread's investment in restaurants.

Cresmalls Group rose 9 to 62 1/2 on market rumours that it may dispose of some of its hotels. Matthew Clark, which has been severely affected by a profits warning in the autumn, rose 10 to 292 1/2 with PDM announcing that it now has a 19.98 per cent stake in the drinks company.

Analysts described as "disappointing" interim results from Merxdown, the cider maker and distributor of Two Dogs, an alcoholic lemonade. Analysts attributed the fall in profits, compared to last year, to a £700,000 spend on promoting Two Dogs, discounts on canned alcoholic lemonade and higher apple concentrate prices. Kleinwort Benson, the house broker, trimmed its full year forecast from

£2.25m to £1.5m. Some analysts speculated that the alcoholic lemonade sector could be a target in the budget for increased taxation. The shares fell 8 1/2 to 100 1/2.

The retail sector strengthened with the market anticipating a tight Budget, which would reduce the likelihood of interest rate rises. Marks & Spencer climbed 8 1/2 to 499 1/2. Kingfisher strengthened 10 1/2 to 63 1/2 and Boots rose 11 to 63 1/2.

FUTURES AND OPTIONS

Table with columns for Index Name, Open, High, Low, Close, and Change. Includes FTSE 100 INDEX FUTURES, FTSE 250 INDEX FUTURES, and FTSE 100 INDEX OPTION.

LONDON RECENT ISSUES: EQUITIES

Table listing recent equity issues with columns for Issue Name, Price, and other details.

FT GOLD MINES INDEX

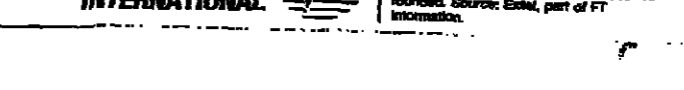
Table showing gold mines index performance with columns for Index Name, Price, and Change.

TRADING VOLUME

Table showing trading volume for major stocks with columns for Stock Name, Volume, and Change.

Large advertisement for FT Business Research Centre. Text: 'Unable to find what you are hunting for? We can track down the information you need... If you were not aware that the Financial Times offers this service, we are pleased to tell you that we do - and at the same competitive prices as in 1994. As a client of the Business Research Centre, you can specify the statistics, news and analysis you want to receive, meeting your deadlines - international information or domestic data; one-off reports or a monitoring programme. If you have a current project, why not fax us details for a cost estimate without obligation?' Includes a coupon form and contact details for Nick Aldrich.

FTSE Actuaries Share Indices table. Columns: Index Name, Day's Change, Nov 22, Nov 21, Nov 20, Nov 19, Nov 18, Nov 17, Nov 16, Nov 15, Nov 14, Nov 13, Nov 12, Nov 11, Nov 10, Nov 9, Nov 8, Nov 7, Nov 6, Nov 5, Nov 4, Nov 3, Nov 2, Nov 1. Includes FTSE 100, FTSE 250, FTSE 350, FTSE All-Share, and various industry sectors.



Highs & Lows shown on a 52 week basis

WORLD STOCK MARKETS

EUROPE

AUSTRIA Nov 25 / Sto

Table listing stock prices for Austria, including companies like VOEST ALPINE and WOLFGANG PERTOLD.

Belgium Nov 25 / Sto

Table listing stock prices for Belgium, including companies like BELFOND and BELFOND.

Denmark Nov 25 / Sto

Table listing stock prices for Denmark, including companies like DANISH AIRWAYS and DANISH AIRWAYS.

France Nov 25 / Sto

Table listing stock prices for France, including companies like AIR FRANCE and AIR FRANCE.

Germany Nov 25 / Sto

Table listing stock prices for Germany, including companies like BOEING and BOEING.

Greece Nov 25 / Sto

Table listing stock prices for Greece, including companies like NATIONAL BANK and NATIONAL BANK.

Italy Nov 25 / Sto

Table listing stock prices for Italy, including companies like ENEL and ENEL.

Netherlands Nov 25 / Sto

Table listing stock prices for Netherlands, including companies like ABN AMRO and ABN AMRO.

Spain Nov 25 / Sto

Table listing stock prices for Spain, including companies like BANCIA and BANCIA.

Sweden Nov 25 / Sto

Table listing stock prices for Sweden, including companies like SAAB and SAAB.

Switzerland Nov 25 / Sto

Table listing stock prices for Switzerland, including companies like CREDIT COMMERCIAL and CREDIT COMMERCIAL.

UK

Nov 25 / Sto

Table listing stock prices for UK, including companies like BHP and BHP.

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OCEANIA

Nov 25 / Sto

Table listing stock prices for Oceania, including companies like BHP and BHP.

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AFRICA

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Nov 25 / Sto

Table listing stock prices for Africa, including companies like BHP and BHP.

Rockwell supplies virtually every European car manufacturer with automotive components and systems.

Rockwell logo

INDICES

Table of various international indices including Nikkei, DAX, and FTSE.

US INDICES

Table of US market indices including Dow Jones, S&P 500, and NASDAQ.

US RATIO

Table showing various market ratios such as P/E, Dividend Yield, and Market Cap/BV.

STOCKS

Table listing individual stock prices for major companies.

INDEX FUTURES

Table listing futures contracts for various indices.

STOCKS

Table listing individual stock prices for major companies.

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NEW YORK STOCK EXCHANGE PRICES

Main table of stock prices with columns for stock symbols, prices, and changes. Includes sections for 'NEW YORK STOCK EXCHANGE PRICES', 'NASDAQ LISTED STOCKS', and 'NASDAQ LISTED STOCKS'.

Advertisement for Hewlett-Packard with the text 'Reach for it. If the business decisions are yours, the computer system should be ours.' and the HP logo.

NYSE PRICES

Table of NYSE stock prices including columns for stock name, price, change, and volume. Includes sub-sections for FT Free Annual Reports Service and AMEX PRICES.

NASDAQ NATIONAL MARKET

Table of NASDAQ National Market stock prices including columns for stock name, price, change, and volume. Includes sub-sections for FT Free Annual Reports Service and AMEX PRICES.

AMEX PRICES

Table of AMEX stock prices including columns for stock name, price, change, and volume.

Cyprus advertisement with logo and text: 'Have your FT hand delivered in Cyprus. Gain the edge over your competitors by having the Financial Times delivered to your home or office every working day.'

US shares climb above 6,500 level

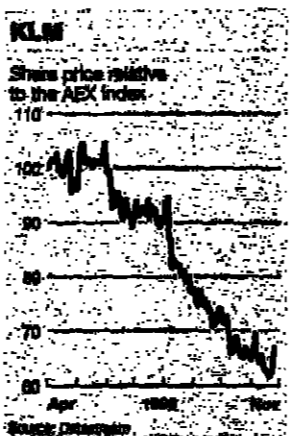
AMERICAS

US shares continued their record course, the Dow Jones Industrial Average piercing the 6,500 mark by early afternoon, writes Lisa Branstetter in New York.

In the Nasdaq, lost 81% at \$120.74 while Microsoft, the second-largest company added 1% at \$51.61.

EUROPE

With the dollar higher against the D-Mark, and Wall Street adding more to Friday's gains, seven bourses reached all-time closing highs in continental Europe.



Ericsson's Finnish stock, Nokia, helped the Hex index to a gain of 6.27 at 2,405.42 but, here again, the real action was in financials; the banks and finance index jumped 1.9 per cent and Merita, the holding group, by 30 penny to FM14.70 on hopes that Skandia might also merge with Pohjola, the Finnish insurer in which Merita has a 16 per cent holding.

banks registered a 1.45 per cent rise. But there were compensating gains elsewhere: Ericsson has climbed SKR3.50 to SKR206, and Electrolux by SKR7 to SKR394 on worldwide optimism in the appliance sector.

FTSE Actuarial Share Indices

Table with columns for Nov 22, Nov 23, Nov 24, Nov 25, Nov 26. Rows include FTSE 100, FTSE 200, FTSE 300, FTSE 400, FTSE 500, FTSE 600, FTSE 700, FTSE 800, FTSE 900, FTSE 1000.

bullish run, ending with the Bel-30 index 6.70 better at 1,871.91; and ISTANBUL added 1.3 per cent to last week's 5.4 per cent gain, the composite index ending 1,095.99 higher at 88,079.86. However, brokers said that the key index was still 12 per cent down in dollar terms compared with its 1996 high on April 8.

Technology shares were also stronger in spite of some profit-taking among the largest companies in the Nasdaq composite. In the early afternoon the Nasdaq, with a content of about 40 per cent in technology shares, was on course to set a new record with a gain of 5.13 at 1,279.49.

CANTV dominates Caracas

CARACAS moved sharply lower during a morning session dominated by trading in newly floated CANTV. The IBC index slid 89.8 to 6,123.8 at midsession.

midsession, the IPC index was off 26.07 at 3,262.22. SAO PAULO and BUENOS AIRES both managed a limited gain. The former was up 0.5 per cent on the Bovespa at midsession following an active morning for Banespa, on talk of conversion of the Brazilian state bank into a federal bank.

Bank float lifts financials as Taipei peaks again

ASIA PACIFIC

Another strong session for TAIPEI propelled turnover up to T\$115.3bn, to mark the most active session since mid-June.

facing tough domestic operating conditions. The Topix index of all first-section stocks rose 4.91 to 3,578.47 and the capital weighted Nikkei 300 by 1.27 to 297.80.

Bank of Osaka Y7 to Y303. Among leading banks, Sakura Bank shed Y30 at Y1,050. In Osaka, the OSE average rose 139.92 to 21,613.67 in volume of 18m shares.

cent over its issue price of Rp850. Brokers said that it had been widely expected that the BNI listing, which was one of Indonesia's best received new flotations, would deliver the market the largest trade in slightly over 17m shares out of a house total of 31m.

Other banks were actively traded, partly on the back of the new flotation and partly because of favourable ratios assigned to them by Standard & Poor's.

MARKETS IN PERSPECTIVE

Table showing market performance in various currencies over 1 week, 4 weeks, 1 year, and since start of 1996. Includes columns for % change in local currency and % change in US \$.

Fall in bullion hits golds

Gold shares stayed weak in Johannesburg, dragging the overall index down by 35.4 to 6,691.3 after another trading session for the bullion price.

Dries fell R2 to R55 and Freegold shed R1.25 to R37.75. The industrial index reversed early modest losses to end up 2.8 at 7,954.45, but trading was very mixed.

Other markets had their own agendas. SHENZHEN's flyaway B share index put

FT/S&P ACTUARIAL WORLD INDICES

Large table showing FT/S&P Actuarial World Indices for November 22, 23, 24, 25, and 26, 1996. Columns include Country, Index, % Change, and Dollar Index.

Real estate advertisement for Calliard Homes, 40 Luxury Apartments, Investment Opportunity in London's West End. Includes details on 28 one-bedroom and 12 two-bedroom apartments, prices from £99,500 to £125,500, and contact information.

BIOTECHNOLOGY 3



British Biotech has raised £250m from public markets, but is unlikely to show a profit before the turn of the century

■ United Kingdom • by Daniel Green

Emerging from obscurity

Industry remains dependent on the success of high-profile companies

This year has been a watershed for the UK biotechnology sector. It has moved from being an obscure corner of UK industry to an intriguing and exciting business where the huge risks appear to be balanced, more or less, by the opportunities for growth.

A year ago there were just eight quoted biotechnology companies researching new drugs for human diseases. Now there are 16 on the main market, plus almost as many again in diagnostics, contamination detection and medical devices, and on the Alternative Investment Market.

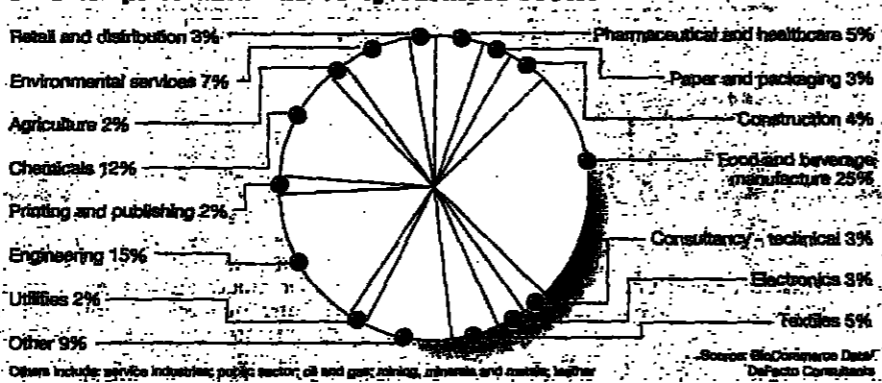
These are only the most visible enterprises. The UK Biotechnology Association lists 892 organisations involved in biotechnology, an increase of 249 over the number counted a year ago*. More than half of those on the list are companies producing biotech products or using the techniques of biotechnology. The rest are in academia, law, finance and other services.

Not all are tiny start-ups. British Biotech's share price rose so high in May this year that its \$2bn valuation made it a contender for inclusion in the FTSE 100 index of the UK's biggest 100 companies. It is still worth about £1.5bn.

The biotech phenomenon is large enough for the government to take an interest. The department of trade and industry's (DTI) Biotechnology Means Business (BMB) programme officially started in March 1996 as an awareness-raising exercise. That four-year, £17m programme was given another £7m in June 1996. It now includes advice on forming new businesses and intellectual property and innovation competitions.

The DTI wants to make contact with 20,000 of the 77,000 businesses it thinks could benefit from using biotechnology. They range from obvious targets such as com-

BMB Helpline data - users by business sector



panies in pharmaceuticals and agriculture, to those in retailing, engineering and construction. Some will use biotechnology only peripherally in, for example, biological markers that identify products as genuine rather than counterfeit. The BMB programme has so far made contact with 9,000 companies.

The long-term success of the industry remains dependent, however, on the fortunes of high-profile quoted companies. This is because biotech start-ups usually need venture capital, whose practitioners need high share prices to cash-in their investments.

Although share prices in the sector often move together, the companies employ various strategies and aim at different customers.

British Biotech personifies the high risk/high reward approach to drug discovery. The company was founded in the mid-1980s, has raised £350m from public markets and further funds from collaborators in the pharmaceuticals industry. It is unlikely to make a profit this decade.

Its enormous stock market valuation is about marimastat, a cancer drug. If marimastat works, it would probably be prescribed for most cancer patients.

To put that in perspective, one recently-launched cancer drug, Taxol, made by US company Bristol-Myers Squibb, is forecast by stockbrokers Lehman Brothers to reach peak annual sales of \$1.1bn a year. Yet Taxol is

only approved for breast and ovarian cancers, with lung cancer a possibility for the future. On that basis, Lehman's forecast of \$1bn a year from marimastat is conservative.

British Biotech's valuation is bolstered by the facts that marimastat is cheap to make and wholly-owned by the company. Most biotech companies earn cash by selling some of the rights to their inventions. And some of their drugs are chemically complex and costly to make.

But marimastat is only part of the way through its clinical trials. Still ahead are the critical Phase III trials, which will be the first in which the drug is compared with rivals in a "double-blinded" trial in which neither doctor nor patient knows which drug is being given. Other drugs which have been just as convincing as marimastat at phase II have failed at phase III.

If marimastat does fail, the damage to confidence in the UK biotech sector could be serious.

One company that might survive better than most is Celltech. Its strategy has been to sell some of the rights to its discoveries. The cash brought in, and the range of research programmes involved, means that it is less dependent on a single product than British Biotech.

As well as earning the money, Celltech has been able to persuade companies such as Merck of the US, and Bayer, of Germany, to

pay for clinical trials, the biggest single item of expenditure faced by a biotech company.

Such partnering can also reassure investors. Why would Merck pay for development if it did not think it was a good investment?

But partnering is a double-edged sword: if a partner abandons a drug, it is a vote of no confidence. And there is a view - sometimes held by executives from companies that eschew partnering - that pharmaceuticals companies are more likely to dump a project they believe to be of borderline value.

Drug development takes about 10 years, but it is a risk that is not compulsory in biotech. Taking inventions in medical devices and diagnostics to the market can be much quicker.

Biocompatibles, based in Farnham, Surrey, is a company that makes coating for medical devices that are "friendly" to the human body. As well as contact lenses, the company is working on stents, mesh cylinders that surgeons insert to hold open blood vessels.

Long-term trials of medical devices like stents are required only in the US. Biocompatibles, which is planning to launch its stents in Europe early next year, was founded at the same time as British Biotech and is likely to be profitable first.

Then there are diagnostics companies such as Dundee-based Sidel, which is preparing a new blood test to predict heart trouble, and others such as Manchester's Aromascan and Cambridge's Celsis which make contamination detection equipment for the food manufacturers.

With devices, diagnostics and contamination detection, however, the risk from competition is higher than in drug discovery. Barriers to entry are lower. Markets are dominated by huge companies such as Chicago's Abbott Laboratories and Johnson & Johnson in New Jersey which guard their territory jealously.

"The trouble with diagnostics is that if you have a good product, a big bear called Abbott comes after you and eats you," says one venture capitalist who has seen that happen with his own investments.

Frightening stories like that seem not to be deterring entrepreneurs from starting their biotech companies.

The 31 quoted biotech companies followed by securities house Yamachi in London employ almost 3,500 people between them. Their shares are among the most actively traded on the London Stock Exchange, and Citv

stockbrokers are telling their pharmaceutical analysts to spend more time on biotechnology. The market capitalisation of the main market 16 alone is more than £4bn.

Several companies are preparing to seek a stock market quotation over the next year. They include Cambridge Antibody Technology, Therexsys, Carebrus, Core Technologies, Oxford GlycoSciences and more. The industry is set to be significantly bigger in a year's time.

* UK Biotechnology Handbook 1996, EIA/ BioCommerce Data, 25 High Street, Slough, Berks, SL1 1DH UK. £120

■ In the markets • by Philip Coggan

Nasdaq is the leader

Developments on European exchanges extend opportunities for funding

Biotech companies can certainly generate stock market excitement. In the year to mid-November, British Biotech shares moved up from the equivalent of 96p to 320p, fell back to 192p and then rallied to 238p.

Given the trading activity they generate and the growth potential of the industry, it is not surprising that stock exchanges are quite willing to attract biotech companies. The problem for the European markets is that the industry has mainly been developed in the US, and the exchange with the most expertise in the sector is Nasdaq.

Nasdaq offers liquidity to shareholders used to owning the famous names of the industry, such as Amgen, and enthusiastic private investors who are keen to chase the next "wonder stock". More than 80 European biotech companies have gone straight for a listing on Nasdaq, rather than opting for a local exchange.

However, according to Nick Woolf, European biotechnology analyst at Nomura, "the past experience of European companies listed on Nasdaq has not been very good. It is hard to keep in close touch with your investors."

Another problem is the intrinsic suspicion felt by investors for any company listing on a non-domestic market. "A basic corporate finance rule is - if a company can't raise money in its domestic market, what's wrong with it?" says Gordon Duncan, director of Kleinwort Benson.

And, although US investors can get very enthusiastic about the biotech sector, it can also fall out of fashion very quickly. "At times, it's been difficult to raise funds on Nasdaq," says Mr Duncan.

The main London market offers a home to biotech companies, under the Chapter 20 rules which allows sci-

entific or research-based companies without a trading record to have a stock exchange listing.

"The main market has done an excellent job in looking after these companies," says Kleitwort's Mr Duncan. "The ideal thing for a company is to get a big blue chip register of loyal long-term investors who will support future fundings. British Biotech (which has undergone a share split) has substantially got the same top quality UK institutional shareholders as Glaxo Wellcome and Zeneca. This loyal UK institutional shareholder base enabled British Biotech to conclude the largest ever funding in this sector."

One unanticipated benefit for UK companies which have stayed at home, according to Nomura's Mr Woolf, is the valuation discrepancy between the UK and Nasdaq, with investors putting a much greater value on UK biotech companies. Eventually this is likely to change as the UK sector develops.

With the main market offering a home to biotech companies, there is little incentive to seek out a quotation on the Alternative Investment Market (AIM), which is designed to appeal to younger companies but lacks the liquidity of the main market.

That may also be a problem for Paris' attempt to attract the smaller company crowd, the *Nouveau Marché*. "If the *Nouveau Marché* is seen as a USM (Unlisted Securities Market - London's first attempt at a bourse for smaller companies) or an AIM, will it meet the biotech companies' aspirations? All emerging pharmaceutical companies should be targeting the most European market - London," says Mr Duncan. Like many new markets, the *Nouveau Marché* is making a slow start; by the end of September, it had only attracted 13 entrants.

The big new development which may attract European biotech companies is Easdaq, Europe's conscious attempt to mimic the US success of Nasdaq (which owns a stake in the exchange).

"Easdaq is designed to be a single market for the whole of European time zone, tapping into investor capital across the continent," says Chris Pickles, director of the European Association of Securities Dealers.

Easdaq was set up at the end of September this year, and the first company to list on the exchange looks set to be from the biotech sector - Innogenetics, a Belgian company specialising in genetic testing, which is planning to float at the end of November.

Biotech companies should have few difficulties in qualifying under the exchange's rules. No trading record is needed, and just 20 per cent of shares need to be in free float. Results must be reported quarterly, as they are on Nasdaq.

While the exchange is starting slowly in terms of attracting companies, as corporate finance departments work their way through the listing rules, it looks as if it should pass the liquidity test. Some 30 European brokers and dealers have registered as Easdaq members and Nomura's Mr Woolf reports no problems in finding market-makers willing to trade in Innogenetics. There is the possibility that some Nasdaq companies may eventually decide to list on its European sister.

There are also hopes that investors will be comfortable with Easdaq. "A Coopers & Lybrand survey found that European institutional investors would be willing to invest 2 per cent of their portfolios in such a market, if the companies were of good quality and the market was highly regulated," says EASD's Mr Pickles.

While Nasdaq is likely to be the world centre for listed biotech companies for the foreseeable future, London and Easdaq should together provide an alternative for the burgeoning European biotech sector. And if one of the European biotech companies can manage to turn itself into the next Glaxo or Zeneca, then the continent's investors will give an increasing amount of attention to the sector.



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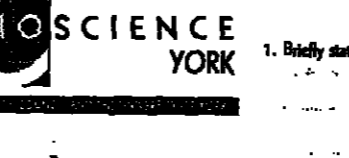
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BIOTECHNOLOGY

Long way from maturity in spite of the promises

A batch of clinical trials over the coming months will strongly influence the industry's direction, writes Daniel Green

It has rarely been easier to make money in biotechnology. Venture capitalists, shareholders in publicly-traded companies and senior biotech executives made enormous gains in the past year as share prices rose.

Yet the industry remains a long way from maturity. Patients have heard little more than promises of new drug treatments from the biotech companies. Some products are now reaching the market, but the vast majority remain in development.

The next few months could be a period of reckoning for the sector. A batch of the most promising drugs candidates complete their final clinical trials. If they work, confidence and investment should rise, if they fail, share prices could fall and plunge the sector back to the moribund years of 1989-5.

Biotech's recent good fortune has been at least partly the result of an unprecedented conjunction of events, according to Steven Burrill, of the San Francisco biotech finance house Burrill and Craves.

The regulatory background has been favourable. European governments are encouraging the creation of new biotechnology companies, especially in Germany where environmental pressure groups have made it difficult to use genetic engineering in research. In the past three months, Germany's Qiagen and France's Geneset floated their shares on the US Nasdaq market.

The Clinton administration's healthcare reform proposals of 1993, which depressed healthcare stocks

around the world for two years, are history. The healthcare industry's view of the next four years under President Clinton is that any proposals to change the US healthcare system would be modest.

Medicines regulators have cut the time they take to review applications for drug approvals. The London-based European Medicines Evaluation Agency, through which drugs can be simultaneously approved across all European Union member-states, pushes through almost everything in a year or less. Before the EMEA, regulatory approval across the EU would take several years.

The time taken by the US Food and Drug Administration (FDA) to approve drugs is at its shortest in living memory. Also, the FDA is taking into greater account clinical trials held outside the US and the opinion of regulators in some European countries.

Shorter approval times are more than just a convenience for biotech companies. Unlike their cousins in the pharmaceuticals industry, they have little sales revenue until products are launched. A delay in approval can trigger serious financial difficulties.

Biotech companies that have benefited from faster approval in the past six years include California's Gilead and Boston's Biogen. They now have AIDS and multiple sclerosis treatment drugs respectively on the market.

This trickle of product launches has added to investor confidence that the industry is capable of producing genuine sales; analysts

at Lehman Brothers, the stockbroker, forecast sales for Biogen's Avonex to reach \$700m a year.

That meant that the best performance from pharmaceuticals company sales since the early 1990s also helped biotech share prices. As pharmaceuticals industry sales improve, so do the prospects for drugs still in research in biotechnology.

And as share prices rose, biotech companies grasped the chance to raise more money through rights issues or flotations.

In the year to November 14, biotech companies raised \$7.2bn from private and public markets, compared with \$3.5bn for the corresponding period in 1995, according to Blowrid Financial Watch, a US newsletter which tracks more than 250 quoted companies and many others in the private sector.

That translates into big profits for venture capital investors. Argyle, a Boston biotech company that floated last month, is three years old. Venture capitalists had invested \$7m and owned half the company. The company now has a market capitalisation of about \$140m.

For senior biotech executives, who are paid largely in stock and options, it also meant serious money. US executives rarely cash in options until a company is profitable, but in the UK Peter Fellner, Celltech's chief executive, exercised options to make a net profit of £1.8m, and two executives at British Biotech exercised share options worth a total of more than £2m.

Flotations reached a peak in June 1996, with \$417m raised in initial public offerings. That proved to be more than investors could stomach, and share prices drifted lower and several flotations were postponed.

The price of this month's initial public offering of

Pennsylvania-based ViroPharma was cut at the last minute from \$11 to \$13 a share to between \$8 and \$9.

There have been some successful flotations in the US, such as that of Argyle. But without further news of progress in important clinical trials, markets and confidence are under pressure.

There remains an unresolved tension between the US and UK markets, the two biggest in the world. It is widely believed, both in the US biotechnology industry and among US analysts, that UK investors are overestimating the prospects for UK biotech companies. One New York analyst is typical. She recommends selling British Biotech shares on the grounds that a US company with products at the same stage in clinical trials as British Biotech's would command less than half the market valuation, that is, that US companies are better value. UK companies and investors say that their US counterparts do not understand the companies they are criticising. According to one, US investors have vivid memories of the US biotech sector's share price crash in 1992-3 after a series of high profile failures of biotech drugs in the final stage of clinical trials.

However, some in biotech have been able to take advantage of the arbitrage opportunity presented by the differences between the two markets. A Californian biotech company, Neotherapeutics, floated last month on Nasdaq but raised a large proportion of the cash in London. The issue was oversubscribed.

Allan Ferguson, general partner of Atlas Venture, a venture capitalist in Boston, Massachusetts, says uncertainties and tensions in stock markets are likely to persist while there is speculation about the outcome of



Global sales grow - profits fall

Billion	Current year		% change	Industry total	
	1996	1995		1996	1995
Financial	8.4	6.8	+23	108	8.4
Sales	11.3	8.7	+29	14.6	12.8
Revenue	3.7	4.3	+10	7.9	7.8
Net loss	2.2	2.3	-5	4.5	4.7
Market capitalisation	47.0	52.0	-9	52.0	52.0
Number of companies	29	283	+13	1,287	1,308
Employees	73,000	80,000	+22	118,000	130,000

Source: Ernst & Young

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<p>BRITISH BIOTECH</p> <p>Rights Issue and Warrants Issue</p> <p>£36 million</p> <p>Adviser, Underwriter & Broker</p> <p>Kleinwort Benson</p>	<p>SCOTIA</p> <p>Placing and Open Offer</p> <p>£35 million</p> <p>Adviser, Underwriter & Joint Broker</p> <p>Kleinwort Benson</p>
<p>VANGUARD MEDICA</p> <p>Listing on The London Stock Exchange</p> <p>Placing</p> <p>£50 million</p> <p>Sponsor</p> <p>Kleinwort Benson</p>	<p>BRITISH BIOTECH</p> <p>Largest single biotech equity fund raising globally</p> <p>Rights Issue</p> <p>£149 million</p> <p>Adviser, Underwriter & Joint Broker</p> <p>Kleinwort Benson</p>

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With applications like this, no wonder Copenhagen is big on biotech

Copenhagen's entry into the biotech sector came in 1983 when Emil Christian Hansen was among the first to develop yeast cultures used in the fermentation of Carlsberg beer. Since then interest and competence in the region has grown.

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GLOBAL CUSTODY

End-game nears for consolidation stage

To stay in the race, global custodians each need to invest up to \$200m a year. Some have dropped out, others have merged their operations. John Gapper discusses the latest moves

The global custody industry is approaching an end-game in its long process of consolidation. Despite seismic shifts such as the recent decision of Barclays and Morgan Stanley to consider merging their operations, the outline of where the industry is heading can already be seen.

At the head of the pack are the large global custodians, which are willing to make the annual investment running into hundreds of millions of dollars to remain dominant.

Names such as State Street, Chase Manhattan, Bank of New York and Citibank appear determined to lead the industry.

Following in their wake are local providers of sub-custodian services and specialised skills which have carved out a distinctive niche. HSEC and Standard Chartered in Asia, and Paribas in France have regional strengths, while consultants such as the WM Company provide specialist services.

Yet, the past year has been as tough as ever on those caught in the middle ground, and obliged to invest heavily to fight for a share of revenues that are ever more tightly squeezed.

The exit of J.P. Morgan last year, and Barclays' recent move, shows how tough many have found it.

"This business can be unforgiving. If you do not keep investing in it, you can quickly fall behind. As soon as one of your competitors stops bringing out new products, it raises questions about their future," says Dan Wywoda, head of global trust and custody for Mellon Trust in Europe.

The shake-out has not only affected global custodians themselves. The largest investment managers in Europe have also started outsourcing custody in an effort to reduce costs.

The primary driving force behind the shake-out has been the squeeze in fees both on basic custody, and on the ancillary services in which custodians specialise.

This has meant an increasing emphasis on scale to make returns on custody acceptable. While custodians used to seek businesses with hundreds of billions of dollars in assets, the minimum acceptable size for a full-service global custodian has come to be measured in trillions.

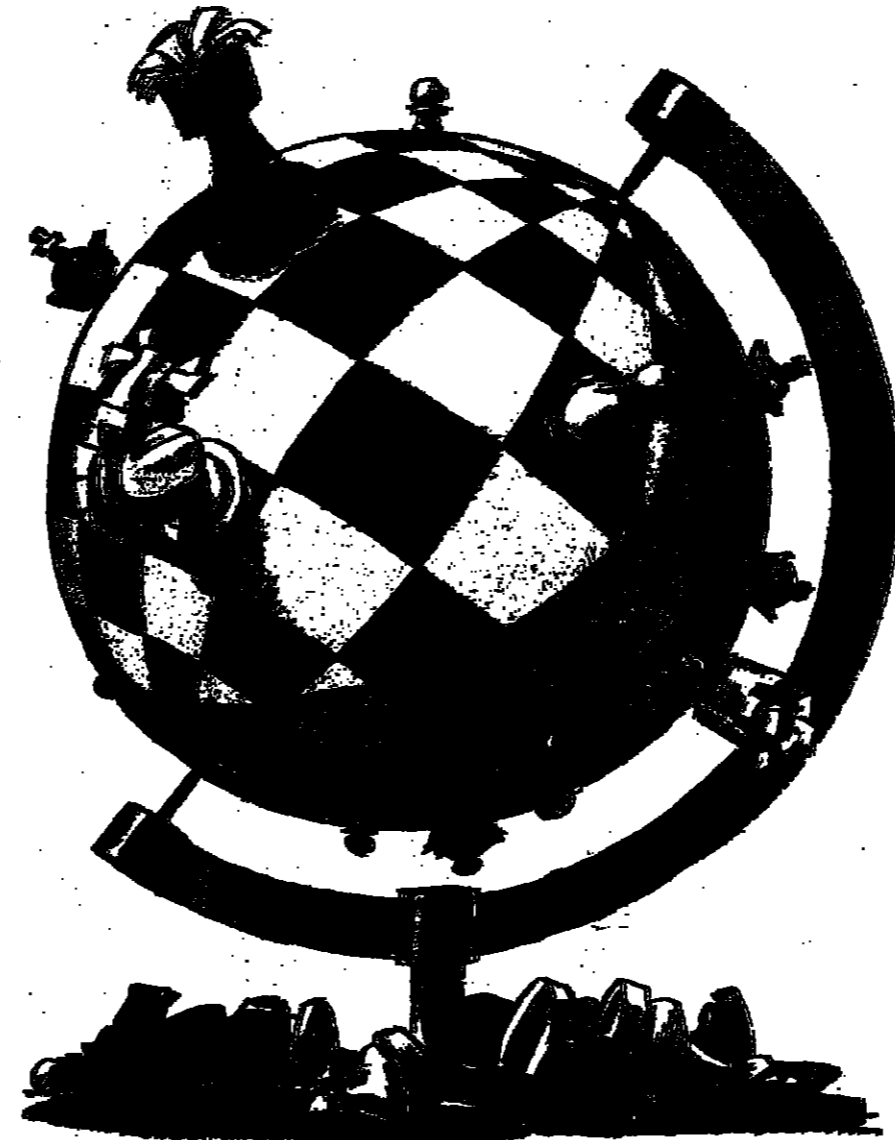
Custodians are still crossing their fingers that the pricing pressure has eased, and they may be able even to raise prices marginally over the next year or two. Mr Freshan of Bankers Trust says custodians used to believe they could raise demand by lowering prices, but have been proved wrong.

"As we move towards an oligopoly in the industry, people are starting to realise that the days of charging low and piling high are over," he says.

Maureen Bluedorn, executive vice-president for global securities processing at Bank of New York, predicts that pricing levels will fall over the next year or two. "I think it is going to bottom out. You can see that trend in one or two proposals, but it will take time," she says.

"If prices fall a little more, that is not going to affect us. It will just force out more of the smaller players," she says.

The fact that words like "oligopoly" - and even "cartel" in private - are now used to describe the industry has caused some doubts among customers. Sandy Jaffee, Citibank's worldwide securities services division executive, says that customers are thinking of things other than price.



have growing requirements for custody.

Paul Maloy, Chase's business executive for global investor services in the European region and Asia, says that emerging markets will be a key part of the business. "So many investment managers are looking at India and China, and do not want to take a risk on local providers," he says.

The alternative is to deepen the business done with existing customers in developed markets. Custodians have attempted to supplement revenue from basic custody with other services, notably securities lending.

Much effort has been spent recently in developing information-related services.

In one sense, custodians are pushing on an open door in attempting to provide integrated real-time data for investment managers. The benefits range from reducing operational risks to allowing them to manage their assets more effectively, for example by telling them how much cash they have.

Ms Jaffee of Citibank says that "our customers' information needs are growing unabated". She says that investment managers increasingly want immediate access to information about

portfolios, particularly about valuation, and the measurement of investment performance against benchmarks.

"Look at what has happened in some emerging markets. Market volatility drives the clients' need for information," Ms Jaffee says.

Yet custodians are not the only ones seeking to provide what have been dubbed "middle office" services such as performance measurement. The danger is that they will lose such business to consulting firms such as Frank Russell, while keeping the lower-margin safe-keeping side of the business.

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houses that has emphasised its role as an "information warehouse", capable of handling middle as well as back office functions. In the Prudential contracts, Mellon has the role of handling information flows, while Midland provides the custody.

Mr Wywoda of Mellon Trust says that although consultants and software houses will play a role in information services, custodians have some key advantages. "If you are handling transactions, it is easy to link that information into accounting and performance measurement," he says.

Given such potential to dominate revenues, some observers believe that a number of banks has acted precipitately in exiting from the business at the low point in the revenue cycle. Simon Thomas, of the London-based consultants Thomas Murray, says that some may regret their actions.

"Very few bankers in the world appreciate the future potential revenue from the business. If you are a bank and you want to gain from the growth in global capital flows, this is a major opportunity," he says.

Nonetheless, things are not always simple for those who remain in the business. Not only are there risks attached to constant investment - "the cutting edge can be the bleeding edge," says one custodian - but the industry is still awaiting its first catastrophic operational loss.

Despite the Maxwell scandal in Britain, and losses on securities lending in the US, the risks of custody are seen by regulators and others as relatively low compared with activities such as lending. There are no capital requirements for custodian

banks related to assets held in custody.

That could change if a custodian makes a crucial mistake in handling a customer's assets at a time of market volatility. Mr Freshan of Bankers Trust recalls one BT manager who, after seeing exactly what custodians did, replied: "This seems to be an insurance business with zero premiums."

Furthermore, the strategy of expansion by acquisition on which most of the larger players are now set carries its own difficulties. Not all customers are happy simply to be handed over. Bank of New York's competitors say that it suffered significant attrition from J.P. Morgan's customer base.

Ms Bluedorn says that Bank of New York has "had our share of wins and losses" since the J.P. Morgan acquisition. However, she says that the 18-month process of integrating the two banks' systems and operations has required a great deal of work, and "planning and attention to detail".

These challenges are becoming greater as the global custody industry approaches the culmination of the phase of consolidation over the past years. The most significant challenge for those who have fought their way to the front will be to ensure that the industry remains relevant.

As technology becomes more sophisticated, the danger is that barriers to entry to choicer parts of the business - information and ancillary services in particular - will lower.

For global custodians who have spent their way to a place at the top table, that would be an unwelcome reward.

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2 BIOTECHNOLOGY

United States • by Tracy Corrigan

Focus is on development

Pharmaceutical companies are increasingly forming biotech alliances

There are signs that the US biotechnology industry is starting to grow up. Ten years ago, doom-mongers predicted that most of the rash of start-up biotech companies would go under. This has not happened. Neither, though, have the wildest optimists, who saw biotech companies as the pharmaceutical giants of the 21st century, been vindicated.

There are a couple of exceptions, such as Genentech and American General, which are now widely viewed as the peers of the big pharmaceutical companies. But most biotech companies remain focused on the development rather than the sale of new treatments, usually through research into molecular biology and genetics, relying for their survival on licensing these drugs to the big pharmaceutical companies, or developing them in partnership.

Many new companies were set up in the late 1980s, and biotech companies usually take about five years to go public and another five or so years to become profitable. Of the roughly 300 publicly-listed biotech companies in the US, around 18 per cent are now profitable, according to Steven Burrill, of Burrill & Craves, a specialist biotech investment bank based in San Francisco. In fact, few companies actually go under. But that is because most companies which are failing are bought out or recapitalised.

Public companies in the industry are still losing just over \$2bn a year, according to Mr Burrill. But the improved access to financing due to the strength of the US IPO (initial public offerings) market in the past two years has allowed many compa-

nies to establish a sound financial footing, at least in the medium-term.

Access to the IPO market has brought "a new era of stability", even for those companies which are not yet making money, says Mr Carl Feldbaum, president of the Biotechnology Industry Organisation (Bio). According to a survey by Ernst & Young, 24 per cent of public companies now have enough cash to survive for at least five years; a year ago, only 17 per cent could look that far ahead.

But the biotech sector of the US stock market fell sharply in the summer after an extremely strong performance in 1995, and this has taken some of the gloss off the IPO market in recent months. Furthermore, some investment bankers say that the best deals have already been done. In the first six months of the year, 62 biotech companies raised over \$1.7bn. But the third-quarter weakness in high-tech stocks took its toll, and capital raised through IPOs dropped from around \$300m in June to \$52m in July.

Still, as the increase in the number of companies making money suggests, there is a positive trend at work. One

element is that the number of products in late-stage clinical trials is reaching critical mass. The other is that the length of time needed to gain regulatory approval has shortened. The US Food and Drug Administration's regulatory reform has led to swifter approvals for Aids treatments and HIV tests, an area in which biotech research has had some notable successes.

These and other recent successes have certainly attracted the attention of the pharmaceutical companies, but acquisitions remain rare. Most analysts believe that Roche's large stake in Genentech, for example, will not set the pattern for the industry. But the pharmaceuticals industry is providing broad support for the industry through partnering. Some partnerships have failed, but given the volatile nature of research and its pay-off, this is hardly surprising. More tellingly, new alliances are being forged.

"The large pharmaceutical companies are now committed to working with biotech companies," says Carl Gordon, a biotech analyst at Mehta & Isaly. Big companies such as Eli Lilly are increasing their

spending on biotech. But they prefer to spend money on a number of partnerships with various US biotech companies. Analysts say this has several advantages.

First, it allows them to reap potential benefits from a broader range of research. Furthermore, the companies already have vast research departments, and do not particularly want to add to those overheads. Also, they may like to be involved in the more entrepreneurial research departments of biotech companies.

"Both the big pharmaceutical companies and the small biotech companies like multiple alliances," says Mr Gordon.

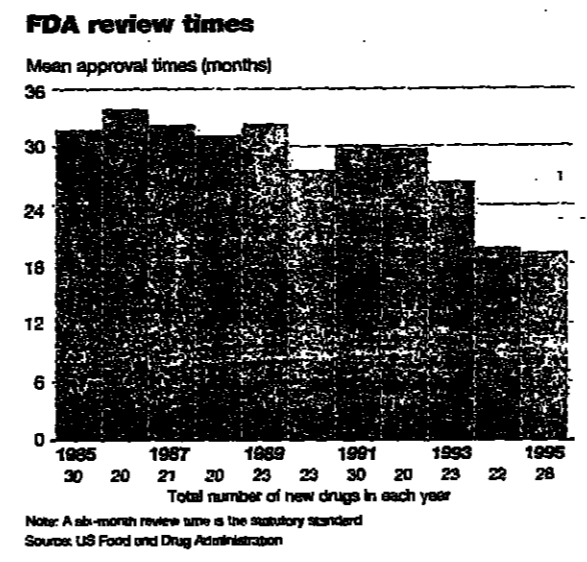
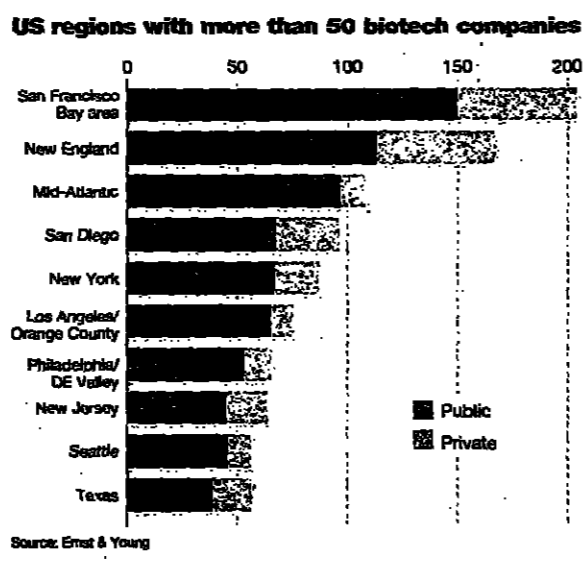
The culture at biotech companies is markedly different from most corporate culture. Many are still described as "Mom and Pop operations", though in many cases, as one analyst said, "Mom and Pop both have ponytails". Most companies are set up close to university research departments, mostly in the north-east and south-west, and have a more laid-back culture than other more conventional companies. One boardroom keeps a bowl of tomatoes on the table...for pelting any

speaker who starts showing signs of pomposity.

Pharmaceutical companies have another reason for their interest in the biotech sector. Their margins have been under pressure, partly as a result of the increased control over drugs prices exerted by managed healthcare companies in the US, such as health maintenance organisations (HMOs). So they are particularly keen to find innovative ways of increasing revenues.

The performance of the biotech sector has been disappointing this year. The Mehta & Isaly Rising Stars Index of 100 mainly US biotech stocks is up just 3.2 per cent for the first 10 months of this year, substantially underperforming the broader US market. Last year, it rose 78 per cent.

But the market capitalisation of the sector, at around \$77bn, is still more than 80 per cent up on the previous year. The pace of the growth may slow as the IPO market tails off, but with new biotech products coming on stream, there is plenty of scope for increased earnings and spending on research.



France • by David Buchan

New market, new opportunities

With so few companies, the French trail their neighbours

"It's warming up", says Denis Lucquin, a partner at Sofintova, one of France's few venture capital firms active in funding biotechnology.

He cites the new opportunities offered by this year's creation of the Nouveau Marché in Paris, the Easdaq (European Association Security Dealer Automatic Quotation) system as well as the state-owned Caisse des Dépôts to set up a FF400m risk capital fund. "These new opportunities and funds are also encouraging old investors to come back into the market," Mr Lucquin says.

But there is still a mismatch between France's high level of fundamental, government-backed research into biotech and the relatively paltry number of specialist biotech companies in the country - estimates at 40 to 50, far behind the UK and now behind Germany. Part of the problem, says Mr Bernard Daugers, of Finovlec, another venture capital fund, is that privileged access to public research in France tends to be limited to a few big industrial groups. For instance, the French government's BioAvenir is a joint venture with the Rhône-Poulenc group.

According to Ernst & Young's 1996 survey of European biotechnology, while "France is home to some of Europe's most established entrepreneurial bioscience firms such as BioMérieux Alliance, Chemunex, Genset, and Transgene, many of France's dedicated biotech companies are little more than small contract research houses unable to develop major products because they do not have the financial foundations to afford expensive, long-term R&D, and thus focus on short-term goals".

France's relatively strong scientific base and relatively weak entrepreneurial tradition has often pervasively resulted in a brain drain of the country's top bioscientists to the US and a counter-flow of US or UK biotech managers and investors to France. But there are new signs of a coming together of the public and private sectors inside France.

A striking example was this year's decision by Professor Daniel Cohen, director of the Centre d'Etudes du Polymorphisme Humain (CEPH) since its foundation in 1983 by Nobel prize winner Jean Dausset, to join Genset, the privately-financed French biotech company. Prof Cohen is to take his team of 25 gene-mapping scientists with him: in return, the CEPH is to receive Genset stock options. Founded in 1989 by Pascal Brandy, a venture capitalist, and Marc Vasseur, a

molecular biologist, Genset now has more than 130 employees, a fully automated sequencing laboratory in the Paris suburb of Evry, and has this year launched itself on the Nouveau Marché in Paris and on the US Nasdaq exchange. It has also this year formed partnerships with Synthelabo, the French pharmaceutical company, to make drugs for prostate cancer, and with Johnson & Johnson of the US to research into genes associated with schizophrenia.

This year has also seen new private French and foreign financing for a smaller company, Biovector Therapeutics, of Toulouse. Also founded in 1989, based on drug targeting technology acquired from France's National Centre for Scientific Research, Biovector has since raised \$24m, enough to keep it going until 1998, when it hopes to go to a public stock market. Two of its products - a nasal influenza vaccine and an ovarian cancer imaging agent - are due to reach the stage of clinical trials next year.

One of the biggest and oldest French companies is the Strasbourg-based Transgene, founded in 1980 and now with 190 employees. Having spent the 1980s as a contract research concern to the pharmaceutical industry and to public disease research organisations, Transgene decided four years ago to narrow its broad interest in gene technology and to

develop specific products for gene therapy in combating cystic fibrosis, cancer and Aids. Investors liked the approach, and provided Transgene with FF250m in 1994, of which nearly two-thirds is still on hand. It has the structural advantage of having BioMérieux Alliance and Rhône-Poulenc as shareholders.

In contrast to the financial environment, France provides a relatively friendly political environment for biotech. Ciba, the Swiss pharmaceutical group, has exploited this in two ways - moving its pharmaceutical-related biotech R&D division from Basel across the French border to Mulhouse in order to sidestep the objections of Swiss greens, and seeking French government sponsorship to try to get its genetically-modified maize approved by the European Union (EU).

"We chose France as the door to the EU market," says Philippe Gay, head of the biotechnology research arms of Ciba Seeds, "because it is the biggest maize producer in Europe".

France cultivates 3m hectares of maize - half of which goes to silage, but the rest is grown for grain, where the pyral caterpillar, equivalent of the US "corn borer", is a pest that costs farmers, on average, about 4 per cent and sometimes as much as 20 to 25 per cent of their crop. The Ciba maize plant contains a protein that kills the pyral larva, which is otherwise difficult to spray because it bores right into the plant.

Ciba has had its modified maize approved in the US, Canada and Japan, but not so far in the EU. The Swiss company's field trials in France won approval in May 1995 from the French government, which transmitted the dossier to the European Commission.

Last spring, the commission's environment division gave Ciba a favourable opinion and sent the dossier out to governments for a decision. It failed, however, to win a majority within the Council of Ministers, because of some abstentions and outright objections from Austria, Sweden, Denmark and the UK. These objections, mostly related to the possibility, even though remote, of the release of bacteria used in the Ciba process, Mr Gay remains, however, confident of eventual victory in Brussels.

Ironically, inside France, the Ciba maize now seems to be attracting more support from the environment ministry than from the agriculture ministry, where some senior officials are having second thoughts. Mr Gay puts this down to new-found caution in the agriculture ministry, having been in the front line against the quite unrelated "mad cow" disease, while the environment ministry sees the advantage in avoiding the need to spray adult maize with insecticide.

Germany • by Sarah Althaus

Public opposition now on the wane

A change in opinion helps to boost a nation's flagging industry

A few years ago, companies such as Biopharm, a small Heidelberg-based biotechnology group researching drugs for the treatment of bone diseases, were scarce in Germany. Indeed, as the biotech revolution swept through the US and UK in the 1980s, tough regulation and ethical controversies prevented it from taking root in Germany.

However, over the past three years, the climate in German biotech has taken a dramatic change for the better and the entrepreneurial sector is now developing rapidly.

The turnaround comes amid waning public opposition to the sector and increased government support. Not only have changes in the genetic engineering law helped speed new product approvals, but the federal government has introduced various investment programmes to promote biotech. The most recent programme, "BioRegion", plans investments of Ecu2.4bn over the next five years.

Some of the regional states have their own biotech programmes, and venture capital conditions - while still difficult - are improving.

"There's no doubt about it, the overall climate has improved since we set up," says Rolf Bechtold, head of analytical services at Biopharm, founded in 1986. Biopharm has isolated a bone protein, MP52, which it licensed to Hoechst, the German chemicals group, in 1994 to develop a treatment for osteoporosis and other bone disorders.

Germany has still a long way to go. The number of companies involved solely in biotech is tiny compared with the US, and most of them are only at an early stage of development, employ fewer than 50, and are not yet profitable.

But progress has been swift, and accountancy firm Ernst & Young says Germany now has more gene therapy groups than elsewhere in Europe. Newcomers in the last two years include MediGene, a Munich-based therapeutics group for cancer and heart disease; CellGenix, based in Freiburg and specialising in therapies for cardiovascular diseases and secondary cancer; and HepaVec, a Berlin company focusing on therapies for liver cancer.

"Gene therapy is a hot spot of biotechnology," says Jane Fiske, biotech analyst at Dresdner Kleinwort Benson in London. "It will take several years before any products reach the market, but there are great prospects."

In the meantime, Germany's biotech companies have been quick to establish licensing and co-operation deals with the established drugs groups, which are increasingly looking to cut costs by outsourcing research to small, specialised companies.

"Demand has changed over the last 10 years: the big groups are turning to small innovative firms to do the research and the drug discovery phases, and the small groups are increasingly seeing the big groups and not the patient as their customer," says Simon Moroney, chief executive of Morphosys, a Munich-based drugs research company. Morphosys is researching

are being given some help through state programmes

a big drugs group later this year. Otherwise, it has a separate profit centre - a DNA analysis arm - which, it says, is already developing "substantial" revenues for the group.

MediGene's main research activities include diagnostic tools for heart failure and therapies for cervical, skin and ovarian cancer. It is also researching a vaccine for the prevention and treatment of cervical cancer and genital warts.

Within its first year, CellGenix formed a joint venture, Metreon, with Schering to research cell and gene therapies for cancer and cardiovascular disorders. According to Felicia Rosenthal, head of the Freiburg-based group, CellGenix is also "the first European group with an official production licence for human cells".

State programmes are providing new businesses with a helping hand, although often not much beyond the start-up phase. The southern state of Bavaria is rapidly establishing a lead in German biotech, having targeted the sector as one of the recipients of funds from the privatisation of state assets.

Bavaria has set up a risk financing fund, Bayern Kapital, which will invest up to DM3m in each company. This matches funds provided by Technologie-Beteiligungs-Gesellschaft, the federal government's risk financing operation.

"The amounts of soft money you can get here are unprecedented," says Mr Moroney. Morphosys has now completed its third round of financing in which each D-Mark of venture capital was matched with two from the state and federal funds.

Baden-Württemberg, North Rhine-Westphalia and Berlin also have biotech activities, while Hesse, where the Green party is dominant, has been less enthusiastic.

However, more active co-operation is needed from



Simon Moroney: 'demand has changed'

venture capitalists. The Netherlands-based Atlas Venture, Techno Venture Management (TVM) in Munich, and Technostart, a Stuttgart-based group, are the only venture capitalists in Germany with a strong biotech interest. The main obstacle has been the relative lack of exit possibilities for investors and the overall risk aversion of the German investment community.

But things are changing on this front, too. Earlier this year, QIAGEN, a Düsseldorf-based supplier of products for screening nucleic acids (DNA and RNA), became the first German company to be listed on Nasdaq, the US exchange on which many international high-tech stocks are quoted.

"QIAGEN's successful listing was a breakthrough as it helped draw US investors' attention to Germany," says Waldemar Jantz, managing partner at TVM. "Germany showed that it has some interesting investment opportunities in high tech companies."

TVM is setting up its third investment fund for high-tech companies, with about 80 per cent of the expected DM150m to DM200m total to be spent on biotech, largely in Germany. Mr Jantz expects between 25 and 30 per cent of the fund to be subscribed by US investors. Dresdner Kleinwort Benson, the investment bank, is contributing up to DM20m, and Siemens, the German engineering group, is also one of the main investors.

Venture capitalists say they would also welcome a local exit opportunity. Hopes are, therefore, pinned on Easdaq, the recently-formed European exchange modelled on Nasdaq, and the Neuer Markt, the small company market planned by Deutsche Börse, which runs the Frankfurt stock and futures exchanges. Mr Moroney says Morphosys plans to list on Nasdaq, and possibly the Neuer Markt or Easdaq as well. In the next 12 months, MediGene has also mentioned a US listing.

"When you consider the quality of Germany's scientific base, it certainly has the potential to become the European leader in biotech: all it needs now is a few successful listings to prove its worth," says Mr Moroney.

There's biotech - and there's biotech

Some pharmaceuticals industry executive are fond of saying: "There is no biotech industry. We use biotechnology ourselves, and many of the so-called biotech companies do not."

The comment is partly true, and wholly disingenuous. The word biotechnology has two meanings, one scientific and one commercial.

The first and original meaning is that biotechnology is the use of living material in technology. The material can be anything from bacteria to yeast to sheep.

It was coined to distinguish it from chemistry, the traditional source of new products in pharmaceuticals and agriculture. In this sense, biotechnology is employed by most large pharmaceuticals and agricultural products companies.

In the past two decades, biotechnology has also acquired a

new meaning, one that is called biotechnology because of their financial structure.

Much has been written about why the biotech industry exists. Why could not the pharmaceuticals industry have done what the biotech sector is doing?

One response is to suggest that the US venture capital industry seduced scientists from academia and the drugs industry with money.

Another is that the pharmaceuticals industry has traditionally done well out of improving existing drugs, spending more on sales and marketing than research and development.

Either way, the biotechnology sector has become a force to be reckoned with. A pharmaceuticals company can employ biotechnology, but that does not make it a biotech company.

companies trying to develop new drugs, diagnostics or medical devices.

These companies want to compete with bigger and established rivals, but they differ from them in that they are small and have few, if any, sales.

That means that more funding comes from venture capitalists than from stock markets and sometimes through partnerships with bigger companies. Most biotech companies lose money for many years.

It also means that its survival depends on making a success of the inherently risky business of research. That leads employees to work long hours, cut costs, sometimes corners, and often take a rose-tinted view of their prospects.

In the early days - the 1980s - many of these companies tried to turn proteins into drugs and therefore used biotechnology, the science. Today many are based on chemistry or recombinant science but are still

Daniel Green

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PROFILE State Street Bank

Specialisation brings rewards

The bank is now No 3 in the US and has \$2,700bn in assets under custody

The phenomenal success in the past two decades of US mutual funds, which now on average take in a net \$20bn in assets and dominate the US savings industry, has created many fortunes.

One of the greatest indirect beneficiaries is the State Street Bank, based in Boston. In 1924 it undertook processing for the first US mutual fund (the Massachusetts Investment Trust).

About 50 years later, by which time it was the fourth largest commercial bank in Boston, it decided to focus on mutual fund processing, steadily retreating from traditional commercial banking activities. This proved to be a good decision. From 1980 to the end of last year, the total value of equity and bond assets managed by the US mutual fund industry grew from \$58.4bn to \$2,067.5bn.

State Street is still the largest processor of US mutual funds. But it has developed from there to be one of the nation's three largest global custodians with \$2,700bn in assets under custody. It has offices in 15 other countries, and completes transactions in 72 countries.

It is still based in downtown Boston, near the street which gave the bank its name, and it still maintains a leading business for local medium-sized companies. But most of its branches have been closed. Its credit card business has been sold, and the profit-producing heart of State Street is its huge processing centre several miles outside the centre of Boston, in the old industrial town of Quincy.

But its growth has been fuelled by fee income, and it now markets itself as a specialist custodian bank, which has devoted more energy than any of its rivals to enhancing the custody role.

Income from fees, rather than interest, now accounts for about 71 per cent of its total profits, and this figure is likely to grow. This has helped insulate State Street against the swings in the economic cycle that affect most US commercial banks.

It has also buoyed State Street's share price, and the bank hopes its relatively high rating will insulate it against any attempts to include it in the wave of consolidation in the US commercial banking sector.

State Street and the two other big US global custodians, Chase Manhattan and Bank of New York, now have \$9,000bn in assets between them. While it has slipped to third in assets under custody, thanks to a series of acquisitions by Bank of New York, it has logged impressive growth in the past year.

Its latest statement of accounts, for the third quarter of this year, show that assets under custody had increased by 30 per cent over the preceding 12 months from \$2,100bn in September 1995. Assets under management - mostly in quantitative and index funds originally developed as an adjunct of State Street's custodial accounting systems - had risen by 40 per cent over the same period, from \$198bn to \$280bn.

The decision to focus on custody came in the wake of US financial services deregulation in the mid-

1970s. At this point, according to David Spina, the president and chief operating officer, "it was incumbent on organisations to do a very rigorous self-examination about where they had significant competences which could lead to competitive advantage. We were the fourth largest bank in Boston, but we were clearly not a leader. Where we had a competitive advantage was not so much global custody at that time but in servicing US mutual funds." This, he said, "begot" pension fund servicing, which in turn begot heavy involvement in 401(k) plans (defined contribution pension schemes offered by employers), global custody, and investment management.

The legacy of the early concentration on servicing mutual funds remains readily apparent. State Street still concentrates on fund accounting and analytics, with information technology which is aimed at allowing highly developed analysis by fund managers both of their own portfolios and of the broader markets.

According to Mr Spina: "We like global custody

The bank decided to focus on mutual fund processing

better when it's coupled with portfolio accounting or analytics of investment performance. A series of services which we have developed in essence build their efficiency on the fact that we already have hard information on our database about the portfolio because we are the custodian."

This is the core of State Street's attempts to stay ahead of its competitors. It has also attempted to protect its lead in the US by offering specialised services for different customers, with systems that accommodate the different insurance regulations for each US state, and the different tax and reporting regimes covering different financial products. For example, there is a big difference between the accounting mechanisms needed by mutual funds, which are required to produce prices daily, and those of pension funds, which face a more lenient reporting regime.

Aggressive investment in technology in the early 1980s was one of the keys to State Street's growth.

Mr Spina believes there are opportunities for further growth, although the focus will increasingly move outside the US, particularly into western Europe where opportunities should arise from pension reforms, and also into the more developed Asian economies. The past year has seen the start of a joint venture with the Unit Trust of India to provide accounting services to the Indian mutual fund industry.

Mr Spina is keen to scotch the notion that State Street's growth will be conditioned by its core business in mutual funds. "It's not clear to us how successful US-based mutual funds have been in penetrating overseas markets. It's important that we establish links directly in those markets" and don't just follow our existing customers outside the US."

John Authers

Outsourcing: by David Cowan

A marriage of resources

Legal risk and credit issues aside, the case for outsourcing seems convincing

Badging, private labelling, outsourcing, call it what you will, global custodians are convinced the practice of farming out custody services is here to stay. Of course, one could ask if this is a view accepted uncritically, only to be later on dropped as fashion changes, leaving a lot of technological egg on custodial faces.

A few years back the big debate was private labelling, a technological sleight of hand whereby the one outsourcing "badged" the service as its own but actually it was farmed out. Outsourcing is more open, in that it is publicly acknowledged that the back office is elsewhere. Today, the private labelling debate is no more, and now we are on to the latest wheeze of outsourcing.

The danger as far as fund managers, and others considering the outsource conundrum, are concerned, is that there has to be a realisation that in doing this they are committing themselves to a marriage of resources, and

the divorce, if it should come to pass, is going to be none too easy.

If the relationship with the outsource deteriorates or changes, then the fund manager is left to decide either to shift the outsourcing to another custodian, or take it back in house, the latter probably more fraught with difficulty than the former.

David Watson, director of marketing and business development at Lloyds Bank Securities Services, agrees. "Once you've made the decision it's difficult to undo it again," he says.

John O'Driscoll, senior vice-president and area head for Europe at Mellon Trust, explains: "Outsourcing isn't for everyone. What you have to decide is whether custody is core to your overall service; if it is then you shouldn't outsource, if it is not then perhaps you should. Fund managers are keeping to their core business, and that determines whether they outsource or not."

One milestone was the outsourcing by Prudential Portfolio Managers, a subsidiary of Prudential Assurance, jointly to Mellon Trust and Midland Bank. Mr O'Driscoll suggests that this is not part of a continuing

strategy to work with Midland, rather that it was an exceptional contract, and it is difficult to generalise on how outsourcing deals are struck, every deal being different.

Different deals lead to the parcelling out of various aspects of the operation, and outsourcing custody may be regarded as a stepping stone to outsourcing the entire back office. What the custody banks aim to provide is a lot of value to the operational life of the institution doing the outsourcing.

Mr O'Driscoll says: "We focus on the value added, the analytics and performance measurement areas. We're not in the business of being the cheapest provider, but we add value to help our clients to be more successful. Part of the skill of our success will be how accurate our vision of the future will be."

There is a credit issue involved and the bank taking on the outsourcing may also be absorbing, to a significant extent, the counterparty credit risk. This is best expressed by Roger Fishwick at Prudential, who tells a story of how a custodian capitalised at \$50bn called him offering to take on his custody, to which he replied:

"We have \$80bn of assets, why don't we do your custody?"

The reason behind outsourcing is based on the technical investment and flexibility offered by those willing to take your business and keep it smoothly ticking over. The specific trends driving outsourcing are increased technology costs and increased competition. The reasons to outsource being the convenience, best practice issues and cost. But is asset size an issue?

"No," argues Mr Watson. "The decision to outsource is based more on culture than the asset size. It depends on the structure of the organisation. Size is a factor but it is not the determinant. He has to decide how he wants to do his business."

Mr Watson elaborates: "Outsourcing is going to be a continuing trend. As the demand for return on capital increases, the fund manager will want to focus on core strengths. The trend towards outsourcing middle office operations will also continue as the core business becomes more competitive, thus driving the business up the value chain."

Post-Maxwell, Barings and other mishaps in the markets, fund managers are



Roger Fishwick Prudential's custody assets worth \$200bn

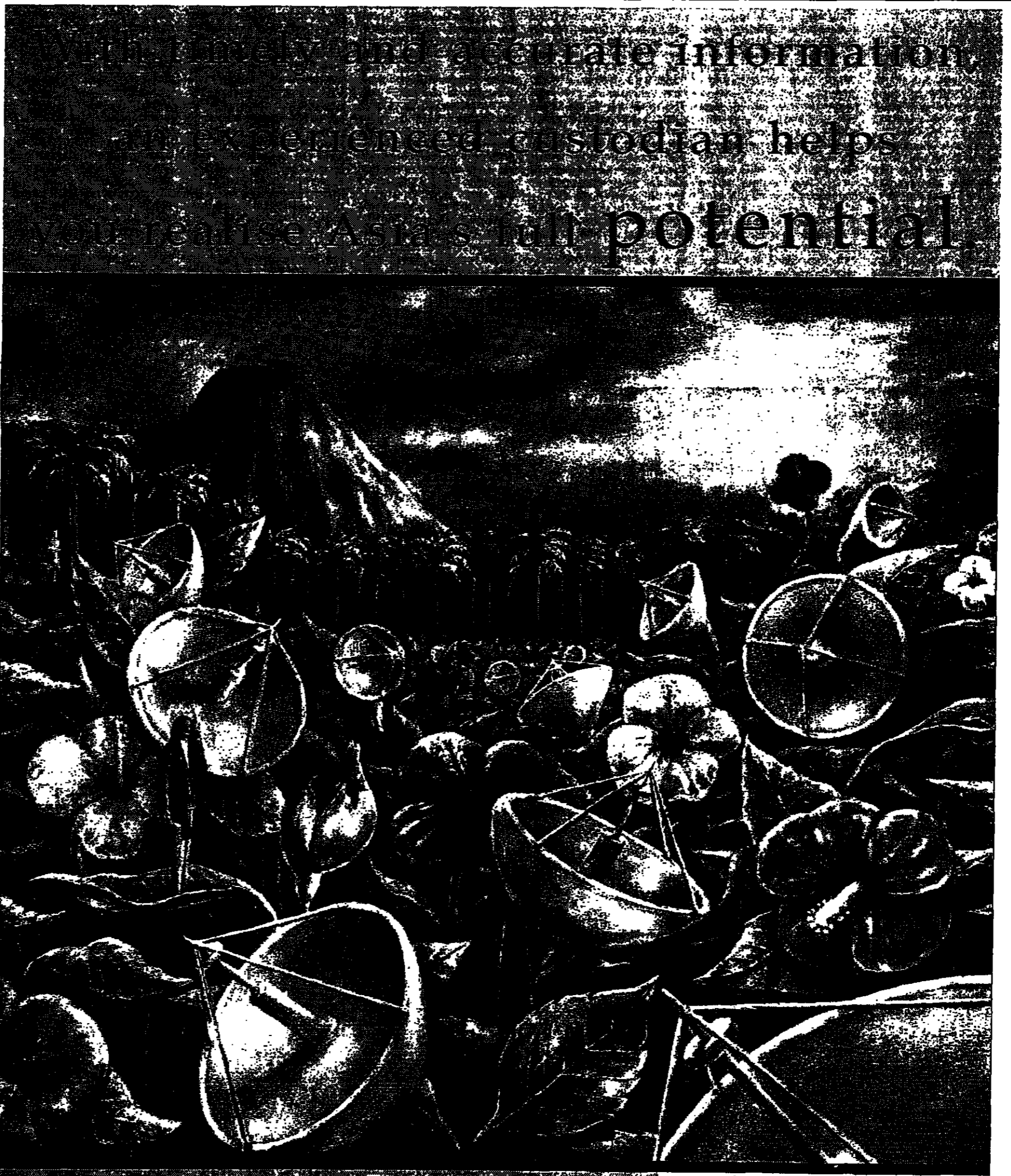


John O'Driscoll 'outsourcing isn't for everyone'

increasingly aware of the legal issues at stake. In one sense, the operational area could be simply said to be one of a legal transfer and monitoring of ownership. The one taking on the outsource is taking on board the legal risk issues as part of the package. Perhaps fund managers, facing increasing legal and regulatory challenges, will then rue the day they outsourced, because they leave themselves at one remove from compliance issues.

Mr O'Driscoll responds:

"In some respects you could argue the other way. As the rule book gets bigger, one comfort might be working with a first class firm used to working with the regulatory regime. This is clearly a very important aspect of the work we are doing." Legal risk and credit issues aside, the business case for outsourcing appears convincing, and with more institutional investors coming to the fore there seems plenty of business for custodians waving the outsourcing flag to chase.



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4 BIOTECHNOLOGY

■ Venture capital • by Mike Ward

Heads are being turned in Europe

Investors used to look chiefly at the US and UK, but now there are other attractions

Europe is experiencing a life sciences gold rush. While the public equity market for European biotech may have gone off the boil in recent months, there is plenty of interest from private equity sources. The European entrepreneurial biotech sector now has some 600-plus companies, and that number is growing weekly.

Investors are particularly interested in getting in as early as possible to take full advantage of the potential upturn in a company's worth. A recent study commissioned by Merlin Ventures, the new British seed capital and management company established by biotech entrepreneurs Chris Evans, Peter Keen and John Morris, identified that the average internal rate of return (IRR) from the first round of financing for publicly-quoted UK entrepreneurial biotech companies was 77 per cent a year. With venture capitalists usually looking for IRRs of 30 per cent a year, it is little wonder that their heads are being turned by the burgeoning European biotech sector.

Celsis, the industrial diagnostics company founded by Mr Evans, gave the best internal return on investment to early backers, while another Evans company, Chiroscience, finished third.

Mr Evans is now looking to repeat his success and boost Britain's position in global biotech through Merlin Ventures and the recently-established Merlin Fund. Merlin Ventures will identify at an early stage leading-edge UK biotech, co-found companies based on the core technologies, and provide seed funding and management support until the companies are in a position to go

for a first round of institutional financing.

"We intend to create value for UK plc by building businesses underpinned by the British science base," says Mr Keen. "And it is our intention to put together and incubate eight to 10 new companies a year."

Merlin has already co-founded its first new venture - the cancer therapeutics development company Cyclacel - in collaboration with Cancer Research Campaign Technology, the commercial arm of the UK cancer charity. It is now constructing a second company, which involves putting six different technologies under one roof.

The Merlin Fund founders are currently attracting investors to the unquoted Jersey-based limited partnership. While 85 per cent of the potential sources of equity in London are not allowed to invest in unquoted stocks, Mr Keen says that potential investors have shown enthusiasm for the concept. In the first instance, some £30m to £50m is expected to be forthcoming, although the fund has a cap of £50m. Mr Keen expects the fund to close its first round of financing shortly.

While the majority of biotech start-ups to be financed by the Merlin Fund will have been co-founded and seeded by Merlin Ventures, the fund will consider other opportunities.

The creation of new companies with managers that have already been round the block once - or in Mr Evans' case, a few times - is an attractive proposition for many venture backers. Indeed, for Patrick Sheehan, local director of emerging businesses at SI, this heavy mix of entrepreneurial business skills and ground-breaking science is now desirable if an investment is to be made.

Mr Sheehan says he is optimistic that the perceived lack of experienced manage-

ment will soon not be a problem as the sector recycles its entrepreneurs. Having already invested in 53 British life science companies it is a testament to the UK's science base that he expects SI to continue to invest.

Some of the funds, however, will be heading for continental Europe. "We have invested in European life science firms in the past, but we are beginning to look in the European direction as more and more professionally managed companies emerge."

The emergence of a relatively robust UK biotech sector and the appearance of new companies in continental Europe is best illustrated by the investment profiles of some of the venture industry's most consistent backers.

Biotechnology Investments (BIL) has seen the geographic spread of its investment portfolio change considerably in the past 10 years. "In 1987, about 90 per cent of our investments were in the US and 10 per cent were in Europe," says Jeremy Curnock Cook, of Rothschild Asset Management, the manager of BIL. "Now Europe accounts for 25 per cent of the investment in listed companies and 40 per cent of the unlisted stocks. There are now worthwhile investments to be made other than in the US."

Recent non-US and non-UK investments include France's BioVector Therapeutics, Ireland's Biotrin International, and Israeli companies Peptor and XTL Biopharmaceuticals.

The success of British entrepreneurs is encouraging other UK scientists to consider taking the business plunge. In collaboration with Johnson & Johnson Development Corp, BIL has established a seed capital business, Healthcare Ventures, to provide financial and managerial support to budding scientific entrepreneurs across Europe.

European bioscience private financing

Company	Amount	Notes
Auda Genetics Cambridge, England	£5.0m	Completed private placement through Hoare Govett Corporate Finance; 31 per cent in SI, 6m
Auda Pharmaceuticals Copenhagen, Denmark	£1.0m	New combichem company receives seed funds from Danish venture capital company DUE
Biotrin Holdings Mount Merlot, Irish Rep	103.6m	Diagnostic technology company raises funds. BIL one of the backers
BioVector Therapeutics Labege, France	\$13.5m	Over-subscribed mezzanine financing. BIL, SI and CDC Innovation among new investors. Sofinova one of existing shareholders
Cerebrus Ascot, England	£2.5m	Neuroscience start-up gets £2.5m from Schroder Ventures International
Core Technologies Kilmarnock, Scotland	£5.8m	Drug delivery technology company raises funds in private placing managed by Merrill Lynch. Rothschild's International Biotechnology Trust makes first non-US investment of £2m
Hexagen Cambridge, England	£4.25m	Mermelian functional genomics company completes first financing round, attracting funds from venture capitalists
IntroGene Rijswijk, The Netherlands	£1.0m	Gene therapy company completes self-managed private placement which included new backers such as SI and GIMV
MediGene Munich, Germany	£4.11m	Gene therapy company raises funds in second round from venture capitalists and soft loans from silent partners
Merlin Therapeutics Cambridge, England	£0.35m	Female healthcare start-up receives seed funding from Healthcare Ventures, a joint-venture between BIL and Johnson and Johnson Development Corp
Oxford BioMedicine Oxford, England	£0.75m	Britain's newest gene therapy company raises funds in pre-robotic placing with institutional and private investors
Oxford GlycoSciences Abingdon, England	\$20m	Completed private placement above \$15m target. Existing shareholders participate, plus new ones, including Sofinova
Pharmagene Labs Royaumont, England	£1.35m	Drug research company focusing on use of human tissue in new medicines raised initial funds from SI and others
Pharming Lelissen, The Netherlands	£1.57m	Transgenic company raises funds in two tranches
Thella Ab-en-Provence, France	FFR32m	Formerly known as Heliosynthesis
Theracore Keele, England	£22.5m	Britain's first gene therapy company completes second round of financing

Source: BIL/Finance, Oxford Business Publishing

Mr Curnock Cook is now looking very closely at developments in France and Germany where sea changes in government and financial community attitudes are underpinning the emergence of strong prospects. "There has always been money for the biotech companies; it has always been a question of whether that money could be put to good use," he says.

Entrepreneurial biotech companies based in mainland Europe should soon find it easier to access venture capital. New funds are being created to support early-stage companies, while existing European venture capitalists are now looking to invest in home grown talent rather than just North American and British prospects. The creation of new stock exchanges focusing on high growth high tech stocks is one of the catalysts for this enthusiasm.

The successes of the small number of initial public offerings by continental European biotech companies in the past year has generated interest both from venture capitalists, who can now see possible profitable exits for their investments,

and from scientists wishing to emulate their peers. For these reasons, French biotechnology may be on the threshold of creating a vital entrepreneurial biotech sector. The French ministry of research is currently looking at ways to promote a

greater market and commercial awareness among its scientists. The flotation of Genet earlier this year - at \$89.4m one of the largest initial public offerings by a biotech company - showed the French scientific and financial communities what

was possible.

One of the main factors underpinning the development of US, Canadian and British entrepreneurial biotech companies has been the availability of public equity. This encouraged venture capitalists to finance the companies because they could see how they would get their returns. But not all biotech company backers are looking for rapid financial returns.

In addition to the likes of Britain's BIL, SI and Merlin Ventures, there are funds being set up where the backers are working with additional requirements. This is particularly true of two new biotech financing vehicles in Germany, being established by Corange, the parent of the German pharmaceutical group Boehringer Mannheim, and by Bayer, the German chemicals, plastics and life sciences group.

In collaboration with Bayerische Vertriebsbank and the Dutch financial group ING, Corange has launched the Global Life Science Limited Partnership. Conceived initially by Corange as a means to provide funding for non-core but nevertheless interesting research from within its group, the scope of the fund has been broadened to consider projects from other sources.

As the name suggests, the fund will have a global focus. In the first round, which closed early last month, the three founding partners each subscribed DM25m and there are plans to add to this DM50m in a second round set to close by July 1997.

■ New technologies • by Clive Cookson

Tracing the way ahead

Fresh sciences give opportunities for reducing costs and cutting trial times

Three new technologies are coming together to transform research in the biotechnology and pharmaceutical industries: genomics, combinatorial chemistry, and high-throughput screening. And underlying all three is informatics, the application of computing power to biological and chemical information.

Genomics, the study of genes and the way they work together, provides a huge range of new biological targets for drug discovery. Combinatorial chemistry enables researchers to make vast numbers of new chemical compounds as drug candidates.

High-throughput screening brings chemistry and genomics together. Robotic equipment tests the candidates rapidly against the targets. Compounds that show biological activity can then be developed further - for example by using a molecular design computer to adjust their structure.

There are two broad reasons why companies are investing in these technologies. Firstly, they hope to generate better treatments for diseases for which current drugs are ineffective and/or afflicted with serious side-effects. Secondly, they want to cut the costs and time taken to produce potential drugs for clinical trials.

In order to remain competitive, all the integrated drug companies have had to build up expertise in all three technologies - both in-house and through webs of alliances with specialist biotech companies and academic research groups.

The three technologies

form a "value chain": genomics companies are most valuable, followed by combinatorial chemistry companies and then screening specialists.

Information about the 100,000 human genes is the most expensive to obtain, has the greatest scarcity value, and is most useful for drug discovery. Biotech companies focusing on genomics include Human Genome Sciences, Millennium, Sequana, Incyte, Myriad, Lynx and Genet.

Best known is Human Genome Sciences, based in Maryland, which formed a far-reaching partnership with SmithKline Beecham, the Anglo-American pharmaceutical giant, in 1993. This has thrown up far more genomic information than the original partners can use themselves - even though George Poste, SB's head of R&D, says almost all his company's new drugs will be based on the HGS alliance - so it has been extended to take in four more drug companies: Schering Plough of the US, Merck of Germany, Synthelabo of France and Takeda of Japan.

Each gene codes for a protein and, if the protein is one that is secreted into the bloodstream, it may turn out to be a useful drug. Examples of protein drugs include insulin, growth hormone, interferons, erythropoietin (to stimulate the production of red blood cells) and tPA (to dissolve blood clots).

Genetics Institute, based in Massachusetts, recently announced a collaboration with two prominent Californian biotech companies, Chiron and Genentech, to identify and characterise the functions of "secreted proteins". GI says its Discover-Ease technology has already identified genes for 5,000 secreted proteins.

But scientists estimate that, altogether, only about

10 per cent of the 100,000 human proteins are secreted - and therefore are potentially useful as drugs. The remainder are an integral part of cells in our body.

In any case, proteins have severe limitations as drugs. For instance, most proteins are large and unwieldy molecules that have to be injected into the patient. (Despite the efforts of the "drug delivery" industry, there is still no good technology for packaging proteins in such a way that patients can take them by mouth.)

The majority of useful drugs are, and will continue to be, synthetic "small molecules" that interfere with the operation of proteins, for example by inhibiting the action of an over-active enzyme. The potential number of atomic combinations that might produce a useful small molecule drug is virtually infinite - which is where combinatorial chemistry comes in.

Although the approach has its roots in the 1950s, combinatorial chemistry only emerged five years ago as a recognised technology. Myriad - using its principle is to combine molecular building blocks into "chemical libraries" of many thousands or even millions of new compounds, generating a previously unimaginable chemical diversity.

The combinatorial philosophy is to carry out chemical reactions in parallel, producing very small quantities of a very large number of compounds for further testing and development. This is a complete contrast to traditional synthetic chemistry, which makes a series of compounds one at a time.

The most common way of carrying out combinatorial chemistry is to use microscopic plastic or resin beads as an anchor, both for the growing chemical compounds and for the tagging

molecules required to record the sequence of reactions undergone by each compound. After every step, the beads are pooled and divided between a number of flasks - increasing exponentially the number of compounds synthesised.

But new combinatorial techniques are being developed all the time. For instance chemists at the UK research centre of Pfizer, the US pharmaceutical group, now sandwich the resin beads between porous sheets of polypropylene. This makes it far easier to keep track and separate them than if they are loose in reaction vessels.

Many small companies are specialising in helping pharmaceutical and biotechnology groups to automate combinatorial chemistry and link it to high-throughput screening. For example, The Technology Partnership, a UK consultancy based near Cambridge, has a consortium of drug companies - including Merck of the US, Pfizer, Takeda, BASF, Ciba, SmithKline Beecham and Chiroscience - using its Myriad automated synthesis system.

Another UK example is Chemical Design, an Oxfordshire-based company that floated on the Alternative Investment Market this year. It has moved from molecular modelling to specialise in developing and supplying software for combinatorial chemistry.

The mainstream computer industry is also beginning to move into combinatorial chemistry. This month Silicon Graphics got together with Tripos, a US chemical information company, to create SpaceCrunch, "the world's largest chemical database" with 150bn compounds. The idea is to give pharmaceutical researchers more candidates for their combinatorial libraries.

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2 GLOBAL CUSTODY

Profitability: by George Graham

Fractional fees bring cheer

After the shake-out, the big custodians are expanding their services

After a period in which basic custody fees have been falling by as much as 15 per cent a year, a string of banks, ranging from JP Morgan in the US to Barclays Bank in the UK, has taken a close look at the economics of global custody and chosen to leave the business.

But despite measuring their basic safekeeping income in fractions of basis points, the few leading custodians that have survived the shake-out of the last year are looking remarkably cheerful.

The biggest global custodians, banks such as State Street Bank, Citibank, Bank of New York or Chase Manhattan, have developed the sort of securities processing powerhouses that have enabled them to keep driv-

ing costs down as fast as fees.

Increasingly, too, the leading custodians have been able to expand their range of services far beyond the standard task of keeping securities in safety, generating new revenues by increasing, speeding up and tailoring the information they can provide to investors.

Even in basic custody, some of those who have chosen to remain in or expand in the business see good growth prospects.

"First of all, there is an opportunity to gain profitability strictly on the fee-driven business of custody," said Maureen Bludorn of Bank of New York, who joined the fast-growing custodian when it took over JP Morgan's global custody operations.

Standard fees for custody in the US are now typically no more than a quarter or one fifth of a basis point, measured on the size of the portfolio, though that can vary depending on the num-

ber of fund managers used and the type of asset.

Fees in other developed markets can also be measured in fractions of a basis point, although some notionally developed economies still have very slow paper-based securities settlement procedures, which adds to costs. That includes Japan and the UK, although the introduction of the Crest electronic settlement system in London is expected to improve that.

On top of these basic fees, custodians can earn some additional income on the investment of cash balances.

But fund managers are increasingly investing outside their home territories, and that increases the level of their demands on their global custodians. In some emerging markets, fees can be 40 to 60 basis points.

Citibank, which does its own administration in most countries rather than relying on local sub-custodians, sees this as an attractive business.

"In some emerging markets there are significant margins, and we obviously have those profit margins in-house," said James Economides, managing director for global custody at Citibank. But emerging markets can also be much more costly to operate in, and involve much greater risks. Not all custodians are sure that they are fully compensated for this.

"The cost differentials of operating in some of the emerging markets versus some of the developed markets are probably on the order of seven or eight to one, where the pricing mechanisms may not give you quite that wide a spread," said David Spina, president and chief operating officer of State Street. Increasingly, however, institutional investors are willing to pay for more than these basic custody services.

Mr Spina says State Street's 100 largest clients use an average of 5.2 different services - up from 4.8 a

year ago. Some of the biggest, such as Calpers, the California state pension fund, will use a dozen different services.

Increasingly, institutions are asking their custodians also to perform a compliance role, monitoring derivatives investments, for example, to ensure that they are not unwittingly gearing their funds, or checking that sub-managers stay within their investment guidelines.

"Historically, custodians dealt in the post-trade world, in settlement, accounting and analytics. Meanwhile, the investment manager's other information needs pre-trade. We are finding ways of avoiding data duplication," Mr Spina said.

Mr Economides insists that custodians are not simply swallowing sub-cost fees on basic custody to reap profits on these higher margin value-added services. "It's not cross-subsidisation. A better analogy is that rather than just selling



Maureen Bludorn: good growth prospects in basic custody

somebody a car, you're inducing them to buy an air-conditioning system as well."

A modest but increasing revenue stream for many global custodians comes from stock lending. The custodian advances a customer's securities to a trader and invests the collateral received in exchange, hoping to create a spread over the yield of the original security.

If that increases the yield on a portfolio by 50 to 75 basis points, it could mean millions of dollars of additional income and make the difference for a fund manager between second and first quartile investment performance.

The spread is split between the custodian and the institution, usually 60:40 or 70:30 in the customer's favour - though Mr Spina says he would prefer to manage stock lending on an agency basis, acting as a "toll-taker" rather than splitting the spread.

Bank of New York and State Street have traditionally been leaders in stock lending, though Chase's merger with Chemical Bank has brought it an added expertise in the field.

But stock lending is not a risk-free business, as Mellon found two years ago when it had to take a \$130m charge to cover losses of customers in its stock lending business.

Value added services require heavy investment if the custodian is to keep up with clients' demands. Global custodians are faced with massive spending on information technology both

to keep their unit costs on a downward path that keeps pace with falling fees, and to provide new types of information more quickly to investors. Pension funds which once were happy with a quarterly print-out may now demand daily statements available on automated voice response for individual employees.

At State Street, for example, that means spending 8 per cent of revenues on new systems every year. Many of the large banks which have decided to bow out of custody have done so because they recognised that they were faced with a massive upgrade to their systems.

As the very largest operators get larger, they can amortise their software development costs over a larger base, and so increase their edge over smaller fish.

With critical mass no longer measured in hundreds of billions of dollars worth of assets but in trillions, that means that the coming years will see more banks taking another look at the economics of custody. Many of them are likely to conclude that it is time to leave.

Crest and UK dematerialisation: by William Lewis

Delays reinforce doubts

Seven deficiencies that must be addressed are cited in a letter to Crest's management

Recent statements by the CrestCo, the company responsible for the introduction of Crest, the electronic share settlement system, have raised doubts that the system will go live as planned in April.

Crest has been hit by a series of delays that have led to share settlements taking more time than expected. Software and other problems have already resulted in CrestCo postponing until next year the transfer of several large stocks to Crest from Tallisman, the paper-based system being phased out. Recently CrestCo produced data to show that the most serious delays had occurred

at the end of October, and that changes have been made to speed up settlement, but doubts persist.

CrestCo has disclosed that some processes, including "circles", a process to settle linked transactions at the same time, have been halted to prevent them delaying other transactions, but were being amended to ensure they work better.

Custodians say that they have spent up to £5m each so far implementing Crest and are keen to see its successful completion. "This is a massive project," says Terry McCaughey, director of Midland Securities Services. "You are talking about dematerialising the UK and Irish stock markets in one hit and there are going to be problems from time to time. But at the end of the day we will be better off in terms of efficiency," he says.

Iain Saville, chief execu-

tive of CrestCo, recently warned stockbroking firms causing delays within Crest that they could face restrictions from regulators on the amount of business they conduct.

The Stock Exchange and the Securities and Futures Authority have been visiting all 248 firms participating in Crest to see how well they are coping. CrestCo has suggested that many of the worst performing firms are smaller private client brokers who have used off-the-shelf software to link with Crest.

However, the settlement managers of several leading investment banks have also targeted custodians, and there have been calls for a delay in the full transition to the new system. The settlement committee of the London Investment Banking Association (Liba) has also called on CrestCo, which is owned by 60 financial insti-

tutions, to agree to a minimum standard contract to end the difficulties. Kleinwort Benson, owned by Dresdner Bank, is thought to be seeking compensation from other participants in the system, including custodians, which it believes have caused delays.

Mr Saville has responded to the complaints of the Liba settlements committee by saying that he would be willing to consider signing a minimum standard agreement when Crest was fully operational, but not before.

In a recent letter to Mr Saville, the Liba settlements committee cited seven "deficiencies" that managers believe must be addressed urgently. It also cast doubt on whether the Crest system will be able to handle the strain that settling trades in all publicly quoted companies will impose.

"We have identified a



Iain Saville: a warning for stockbroking firms

number of deficiencies in the Crest system which we believe must be addressed to enable Crest to handle any increase in volume," the letter said. "The fact that these problems have emerged at such low volume levels suggest that there is a need to re-examine the assumptions made about the usage of the

Crest system - both in terms of overall volumes and the pattern of use - and to reassess capacity requirements."

The Liba committee letter also listed a number of participants in Crest, including custodians, whose performance has been "poor".

In response, both custodians and CrestCo argue that the problems should be viewed as temporary and that once Crest is fully implemented it will greatly improve the efficiency of the settlement system. With most other stock markets, in the developed world and in emerging markets, ahead of the UK in introducing so-called dematerialisation, custodians argue that there is no turning back from Crest.

Most remain optimistic about Crest eventually being the platform for a significant expansion of their business opportunities. Some draw a parallel with developments in the US after stock certificates were immobilised, or

kept in a central depository as a compromise measure falling short of complete electronic dematerialisation. Several US custodian banks have since expanded into trade reporting, foreign currency control and performance measurement.

In contrast, Taurus, the Stock Exchange's electronic settlement system which was abandoned two years ago, was a worrying development for custodians. Many of the big fund managers were planning to be their own account controllers and would have taken many processes in-house.

Crest has led to fund managers, many of whom have offered in-house custody to pension fund clients in the past, thinking about outsourcing. In January, Prudential Portfolio Managers, the investment arm of Prudential Corporation, awarded the contract for the global custody of \$45bn of assets to Mellon Trust and Midland Securities Services. Midland

is providing global custody for all assets outside the US, and Mellon Trust, part of Mellon Bank, will act as custodian within the US, including safe keeping, trade settlement and the collection of dividends.

Andrew Brookes of CrestCo details several advantages that the new system will bring. He says that taking paper transfers out of the system will "significantly reduce the likelihood of fraud".

"Those not holding assets in dematerialised form will find it extremely difficult to benefit from the shorter settlement cycle," he says.

Custodians, Mr Brookes says, should not be concerned. They "have an upfront cost which should yield them financial benefits in the future. They are used to spending heavily on information technology and eventually should yield a financial return on what they are doing in Crest compared with paper processing".

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PROFILE

Focus on quality

Germany's largest bank regards itself as the domestic market leader in global custody

For much of its 125-year history Deutsche Bank was a reluctant custodian, holding clients' securities and exercising the voting rights on their equities without turning that chore into a worldwide business. Then the bank's management realised the enormous business potential of custody and from a standing start five years ago, Deutsche Bank has become one of the largest providers of local and global custodial services.

Deutsche Bank did not reveal the size of its custody business until two months ago. Total cross-border assets of \$457bn under custody put Deutsche Bank in fourth place worldwide after Chase Manhattan Bank, Citibank and the Bank of New York. The bank's client base includes 2,500 institutional investors.

More significantly, Deutsche Bank's global custody business is now making a profit, as are "almost all" of its 24 local custody operations, according to Peter Grafunder, global head of international custody services.

Germany's largest bank already regards itself as the domestic market leader. Together with its closest domestic rival Dresdner Bank, the bank estimates that the two banks combined have an 85 per cent share of cross-border international business in D-Mark securities. But Mr Grafunder argues that local markets, however large, will lose their significance once the European single currency has been introduced.

"Investors will want only one cash account, so cash management will be far easier than it is today as long as someone in Europe can offer the right euro-custody product."

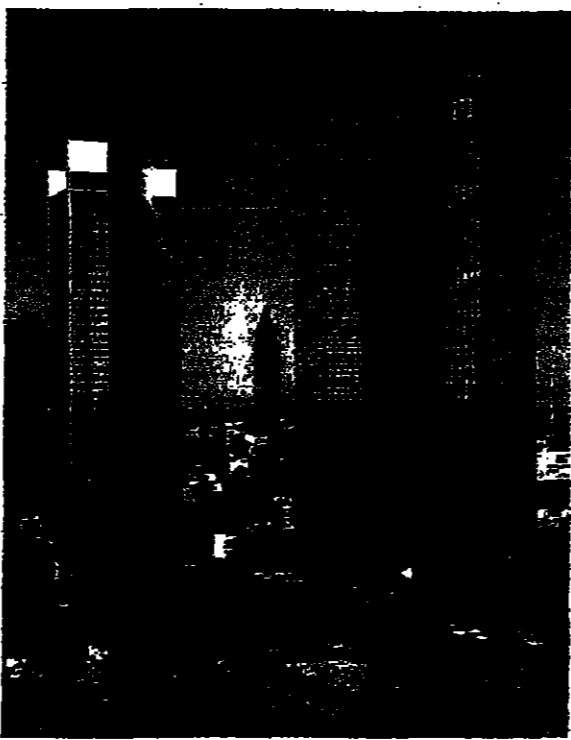
Deutsche's strategy is based on twinning local custody operations with global expertise. While local knowledge was traditionally enough to satisfy the majority of clients, who do business in just one market, says Mr Grafunder, custodians will in future need global expertise too to serve the growing number of clients who hold assets in various currencies.

"Custody practice is changing as asset allocation becomes more international. Under the Hamsbank system (where customers deal with one bank in each market) there was no concept of global custody. But once clients begin investing in other currencies, they need an independent custodian."

"The big weakness of local providers is that they know the local market excellently, but lack the experience Deutsche Bank has acquired from a range of markets," Mr Grafunder believes that the lack of local expertise in many markets is the reason why a series of competitors, most recently Barclays Bank, have decided to leave the custody business.

Although Mr Grafunder perceives "a desperate need for cost reduction", he will have few opportunities to achieve this. Deutsche Bank is investing hugely in technology to reduce its operations staff and to offer new custody services.

Margins in developed markets such as Germany are low because all custodian banks are capable of offering basic products, and there are few opportunities to offer value-added services. Even in eastern Europe, lower prices are difficult to achieve because "service comes at a premium and the locals don't have a tradition in dealing



Deutsche Bank one of the world's largest custodians

in securities," Mr Grafunder says. Therefore he argues that price is not the real issue. "We don't compete on price, we compete on quality." He defines this as a broad infrastructure, highly-qualified staff and specialised software systems. The bank's recruitment philosophy is simple: to hire the leading local expert in any new market. But Mr Grafunder admits that this is often impossible. In some countries there are no experts available.

The lack of qualified staff is one main reason why Deutsche has not yet established any local custody operations in eastern Europe, with the exception of Prague.

Deutsche Bank recently set up a subsidiary in Budapest, but Mr Grafunder has no specific plans to follow with a custody operation. He notes that several local banks, such as Bank Handlowy, Budapest Bank and International Moscow Bank, already offer competent local custody in the region, and Citibank is already there on the global level. Deutsche Bank will enter the market, too, only if it can outperform the best

local provider. Next year, Deutsche Bank's custody staff will analyse the other markets in eastern Europe, where custody volumes are still small, and decide whether to set up more local operations. "The questions we will ask are how big is our market share? And can we get the right staff?" Mr Grafunder says.

Global custody cannot develop at its own pace, but must follow as commercial banking operations are set up in new markets such as the countries of central and eastern Europe. So far, the custody operations are only in Prague, which is already seeing a return. All other markets are handled from the bank's global custody offices in Eschborn, an office park just outside Frankfurt. "We're keeping a very low profile in the Czech Republic at the moment."

The custodian is called first if a client faces a technical problem, says Mr Grafunder, who has 135 client support staff at Deutsche Bank's custody headquarters just outside Frankfurt.

Laura Covill

Regulations by John Gapper

Regulators drag their feet

It is unlikely that regulations will be tightened soon because there is a lack of consensus

The fact that the UK is only just getting around to making custody an activity that requires authorisation is a reasonable indication of the importance that has been attached to regulation of global custody. Despite the trillions of dollars of assets involved, regulators have moved slowly.

In part, this is because of the extreme variance in local practice in safeguarding assets held with another party. While it appeared to be mere commonsense in Anglo-Saxon countries for banks to segregate their clients' assets from their own, the opposite principle holds in Japan.

The result is that global custody still lacks stringent regulatory requirements. The US Securities and Exchange Commission has eased its regulations on custody of cross-border assets held by mutual funds following lobbying from the global custodians most strongly affected.

In August, the technical committee of Iosco, the international grouping of securities regulators, made a series of broad recommendations on ways to protect client assets. However, it emphasised that all regulators had to follow insolvency laws and traditions in casting regulations.

One of Iosco's main recommendations was for all regulatory authorities to recognise the benefits for investor protection and confidence in financial markets of effective mechanisms to protect client assets from the risk of loss, and the insolvency of local investment firms.

However, industry participants doubt whether they have heard the last on the subject from regulators. Indeed, some bankers say that if the inherent risks of custody were better reflected in regulations, it would help to ameliorate some of the cut-throat price competition

in the industry. "In all honesty, the issue has been highly fudged by regulators," says Dick Freeman, division head of global institutional services in Europe and Asia for Bankers Trust. "A monster trauma has not hit the industry yet, and I think it requires that I just hope it doesn't happen to us."

The UK approach to regulating custody emerged in the wake of the Robert Maxwell affair with the publication of a Securities and Investments Board consultation paper in August last year. This suggested that custody should be made an authorised activity, and suggested regulatory standards.

The Treasury is now working on rules for the authorisation of custody companies. In practice, it is unlikely to mark a sea-change in regulation, since virtually all companies practising custody, apart from some Personal Equity Plan administrators, are already authorised for other activities.

The SIB acted on concerns from bodies, including the Society for Practitioners of Insolvency, that client assets were not sufficiently segregated by law to prevent them being lost if a company collapsed. This concern was inflamed by initial doubts over client cash deposits over Baring collapsed.

These SIB standards are now being transformed into firm regulations by the relevant self-regulatory bodies, the Securities and Futures Authority, and the Investment Management Regulatory Organisation. However, the SIB standards have not turned out to be particularly onerous for the industry.

In particular, the possibility of separating client assets from those of a custodian by placing them in separate nominee companies was not regarded by the SIB as worth the disruption and cost involved. A cost-benefit analysis carried out by the board put the cost of implementation at £100m.

Separately, neither the SIB nor any other regulatory body has made an effort to devise capital adequacy

rules for custodians related to the client assets held in custody. The existing UK regulations devised by Imro merely require companies to have capital of up to 13 weeks' expenses.

The principle behind this is that any custodian will have sufficient time to run down the business in an orderly fashion, and transfer custody to another institution, in case of trouble. Regulators argue that it would be impractical to make any form of capital charge in proportion to assets.

"It is inconceivable that any custodian could hold capital that could in any way match assets held in custody. We are talking about firms with billions of dollars in custody," says one official.

'A monster trauma has not yet hit the industry, and I think it requires that'

Regulators argue that it is better to insist on firms having adequate systems and controls.

In theory, the lack of capital adequacy requirements is not a problem because custodians act as agents rather than taking on any direct risks from movements in value, or losses, of securities. A similar approach to linking capital to operational expenditure is used for UK fund managers.

However, not all analysts agree with this approach. Simon Thomas, of the consulting firm Thomas Murray, says that the SIB review "walked away from the major issues facing the industry". He argues that the true risks inherent in cross-border custody are far higher than has been recognised.

"There are a large number of risks that are subterranean and have not been recognised at the moment. Regulators and custodians have failed to recognise that

banks that issue payment instructions are de facto principals. They cannot maintain agency status if it goes wrong," says Mr Thomas.

Most custodians agree that they would in practice be forced to make up any loss caused by errors. Not only have US courts taken this view in cases of error related to securities lending, but it is a commercial necessity. "If we walked away, we could say goodbye to our reputation," says one.

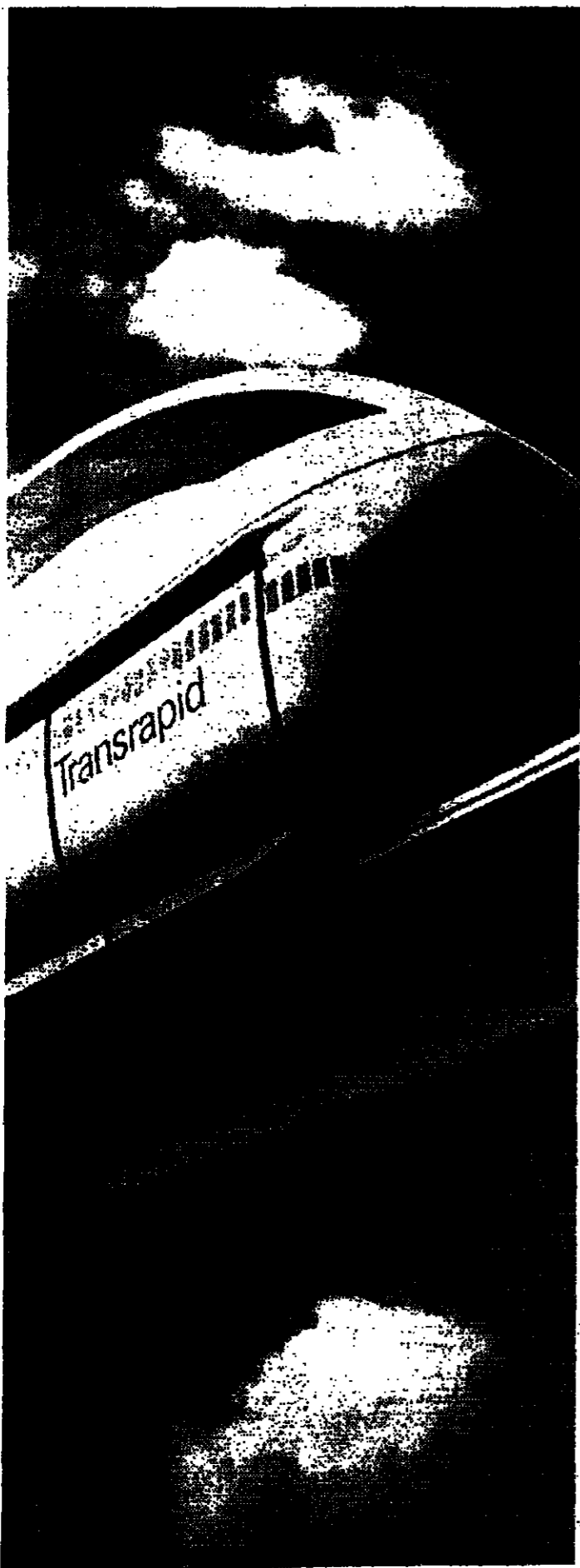
This implies that - similarly to the case of potential losses affecting unit trusts managed by Morgan Grenfell Asset Management, where the group's parent Deutsche Bank stepped in to make good the loss - any global custodian faces huge potential liability for making operational errors.

Mr Thomas believes these risks are eventually bound to be reflected in capital charges levied on custodians in local markets where the risks are appreciably higher. These risks are currently only reflected in higher charges for custody services in markets with poor settlement systems.

He argues that these capital charges will be passed straight through to investors in higher charges by custodians, implying that investment banks that lack custody operations will suffer. He says this is one important reason for banks with strong balance sheets to specialise in custody.

For the moment, a lack of regulatory consensus among members of Iosco, together with differing local traditions, make it highly unlikely that a concerted push for tighter regulation will emerge rapidly. However, this could change if an equity market crash led to a custodial failure.

Yet the compression of pricing in the industry in the past five years has in effect eliminated any notion of pricing correctly for risk. That could come to be seen as an unfortunate omission by both regulators and custodians themselves if the subterranean risks of custody surface.



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4 GLOBAL CUSTODY



Securities lending has been tainted by association with the Mirror Group pensions fiasco

■ Securities lending: by Margaret Morris

An ill-deserved reputation

Despite slim margins, more institutions are lending. But there are risks

In the UK, simply mention the words "securities lending", to a pension fund trustee and the reply is likely to be, "We don't do securities lending".

Tainted by association with the Mirror Group pensions fiasco, securities lending has suffered from an ill-deserved reputation in the 1990s. As Ralph Vitale, senior vice-president of State Street Bank in Boston, says: "For the amount of money that can be made in securities lending, the risk should be as close to zero as possible." Mr Vitale's statement contains two important nuggets of information that any institution - pension fund, insurance company, fund manager or unit trust company - should keep in

mind about securities lending. First it is a low margin business; huge sums are not available for the making. And second, anyone engaging in securities lending, as with any investment management activity, should consider the risk/reward trade-off carefully.

Even with these caveats, securities lending - both as part of the global custody package and by customers using so-called third-party agents - is growing in the UK. The changes in the settlement of gilts and a growing understanding of the mechanics (and profits) of international securities lending have forced many UK institutions to rethink attitudes.

For one thing, a low interest-rate environment makes any investment institution look for ways to squeeze what profit it can from assets. One way to make assets work harder is securities lending, where stocks or shares are loaned to another

institution - which needs them to, for instance, cover a failed trade or a short position. In return the lender receives an equal or greater amount of financial collateral, normally cash or securities, on which it earns a return.

Because increasingly, UK institutions use a custodian for the safekeeping of assets, the custodian bank is well placed to facilitate a securities lending programme, since it knows first what assets are available for loan. Simon Murray, a director of consultants Simon Murray, says: "All our requests for proposal (RFPs) to custodians ask for information about securities lending. And all of our clients are reviewing whether they should be in it."

Although unit trust companies have been allowed to engage in securities lending for several years, neither they nor UK pension funds are important operators in securities lending at home or abroad. "For very large insurance companies and quantitative asset managers, securities lending allows them the ability to invest more specifically the kinds of risks that they are running in securities lending."

To assess the risk/reward trade-off, many public and private pension funds in the US have been putting their securities lending programs through the type of performance analysis that they had in the past reserved for investment managers. Mr Vitale says: "Performing risk-weighted return analysis is a step in the right direction. Securities lending is no longer simply a back-office activity. It is a hybridised investment management activity."

Risks run by investors involved in securities lending fall into three main categories: collateral risk, counterparty risk and operational or transactional risk. The one that causes the greatest grief is collateral risk. When an institution lends a security, the collateral it receives can range from cash (in some jurisdictions) all the way through to equities. Managing that collateral is the key to the return. It is also the security for the assets out on loan and must be monitored to make sure it is still worth as much as the loaned securities. Shortfalls in investment returns accounted for many of the headaches in the US in 1994.

Counterparty risk is, broadly, the risk that the counterparty institution, which has borrowed the securities, will go bankrupt. In practical terms, it means that if the borrower is a low-rated institution, a higher level of collateral will be necessary. And operational risk covers the gamut of

technical problems involved in the entire transaction.

What performance analysis attempts to do is to quantify what portion of the return received from securities lending is attributable to these risks. At the end of the day it attempts to answer the question, "Are you, the lender, making an appropriate return for the risks you are running?"

According to Orrin Bargerhuff, of Bargerhuff & Associates, a Dallas-based performance analytics consultant, "the easiest test for a lending programme is return. If a programme is making 10 basis points more than anyone else in the market, it is running higher risk." State Street's Mr Vitale says: "If you are making an outside return in securities lending, you are probably running far more risk than you know."

It is easier to separate returns now, that US pension funds are beginning to move away from bundled custody and securities lending. In bundled pricing, both activities are done by the custodian, which offsets the income against the cost of custody. However, during the custody price wars of the early 1990s, the true cost of each activity was obscured, as prices reached zero at a particularly cutthroat point. Now many clients are looking to find the best provider for each service on its own, paying two bills.

"In some cases, with the larger fund, we see multiple lending providers, which could include the custodian for one piece, an agent for another and a broker/dealer for yet another," says Mr Bargerhuff.

This move to multiple providers comes not only from a desire to understand the actual costs, but for large funds with a broad range of international securities lending, which may be looking for specialist lending agents as well. "You can't expect one bank to be as good at emerging markets lending as European major markets," says Mr Bargerhuff.

Outside of the US too, large institutional lenders are beginning to tackle the thorny issues of risk and return. At Securities Finance International, a London-based consultancy, a pilot project is under way to assess the risks and returns of international securities lending. "We have teamed up with Barrie & Hibbert, an Edinburgh-based risk consultant, to develop a method for analysing the risks and returns of a securities lending programme in a systematic and statistical way," says SFI managing partner Charles Stoptford Sackville. It is firstly an aid to setting policy and then a process to monitor compliance with stated policy.

■ Euroclear and Cedel Bank: by David Cowan

Rivals eye each other closely

Both organisations have undergone changes as they prepare for even greater competition

Since their formation in the late 1960s, Euroclear and Cedel have eyed each other closely across the Ardennes, but in recent times there has been more of a competitive glint in the Cedel eye. Euroclear has always been the elder, the one with the biggest market share able to boast of its secure Morgan backing. Its younger sibling has always been the somewhat undisciplined rival, often getting market share because it was the only alternative.

All that started to change about eight years ago, when Cedel appointed André Lussé as its chief executive officer. Since then there has been a succession of resignations,

sackings and management changes, often tainted by acrimony.

But this has been at the heart of the cathartic process by which Cedel Bank, now armed with a banking licence, has been transformed from the rotten borough of a handful of Luxembourg grandees into a tough international competitor which clearly now has its rivals in Brussels worried.

This is seen in the response by Euroclear, which has become more aggressive in a sedate kind of way. The appointment of Luc Bomans as chief executive officer has made Euroclear more client-driven, a little less like the civil service management mentality of old. There has been less

reliance on assuming a market share of two-thirds and more on protecting that share, and Cedel Bank has been able to wrestle away some of it in important areas

such as collateral management and repo.

Last year, the total value of securities transactions within the Euroclear system totalled \$25,000bn, a 14 per cent increase on the year, and \$10,000bn within the Cedel Bank system, a 36 per cent increase on the year. The other key figure is the value of deposits held within the systems, which in Euroclear stands at \$1,940bn, a 10 per cent increase, while Cedel Bank exceeded the \$1,000bn mark after an 18 per cent increase on the year.

Ignace Coombes, managing director and head of commercial division at Euroclear, states: "Yes, we've seen a different positioning by Cedel, they are doing more and more, but we come from a strong position, especially with the broker/dealer community. The indications are that Cedel wants to compete, to match what we do, but market share is still relatively stable. Maybe they are now trying different ways to challenge our client base."

Euroclear remains steadily dominant in broker-dealers, which Cedel Bank through its Liberty subsidiary is striving to break into. Cedel Bank, meanwhile, remains dominant in the global custody area, and in moving up the value chain have to ensure they do not alienate their natural constituency. Both organisations are seeking ways to capture the custody business further up that value chain.

Bach has taken a different strategic direction, driven by quite different motivations. The Cedel Bank motivation is driven by opportunity, seeking to capitalise on their flexibility and responding to market changes. The Euroclear strategy is a defensive one, having had the lion's share of the market they are trying to fend off Cedel Bank with one hand and the local

depositories with the other.

Both organisations are aware of the competitive threat of local Central Securities Depositories (CSDs), since they are seeking to bring processing back into their markets, with Sicovam, Intersettle and the German DKV being the most notable. André Lussé responds: "We see ourselves as complementary to the CSDs, we do not compete with them, rather we flow liquidity to their market and we administer the securities at the CSD."

A sensitive area has been the discussion over the new bridge agreement, building on the existing bridge linking the two of them. At present the bridge remains an overnight batch process, but it has always been acknowledged that this would become more of a continuous process in a new bridge. That has been delayed, and the two sides have yet to fully agree on how to proceed. In part, this is complicated by new in-house developments as both ponder the ultimate move to real-time processing.

Mr Coombes explains: "The new agreement has still to be agreed, there is no clear answer on this. We would be ready to implement a new bridge, but both parties have to be willing and to see benefit in doing so. There are a lot of initiatives going on at Cedel and we're working on real-time solutions, so perhaps there is less desire to do it."

Euroclear has already embarked on an ambitious plan to create real-time, which will cost them more than \$100m by the end of the decade. The aim is to become an all-singing, all-dancing central European processing hub, thereby hoping to force Cedel Bank into a niche position and take the European stage for themselves. Mr Coombes says: "The real-time project is progressing as planned and on schedule for the first quarter of 1998."

He is critical of the Cedel Bank approach, arguing: "We are taking an exhaustive approach. Cedel has a more fragmented approach, it is not integrated. We are evolving to real-time and everything will be included and integrated. They start with components and they will face difficulties in integrating these into a real-time environment, so they will do more in a batch processing mode."

Cedel Bank feel they have a more flexible solution. Mr Lussé explains: "We are a customer-centric organisation and we have a network of links to domestic markets. Many customers and markets cannot accommodate real-time settlement. We prefer to talk about settlement as 'continuous'. The technology is on-line, real-time but the settlement process can therefore be real-time or batch. That responds to the different customers and different markets."

Ultimately the aim of both organisations is to hold collateral, and it is this which determines the strategy. The defensive element for Euroclear lies in keeping its lion's share of assets within the system, protecting the deposits. An analogy is in football where you play for a draw. The danger in this approach may be that if the opponents score then you end up in a very different game. Cedel Bank, like the CSDs, are very much on the attack.



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6 GLOBAL CUSTODY

Latin America: by Daniel Dombey

Case for reforms

Governments and security agencies are trying to modernise the sector

After the problems of 1995, Latin America has returned to favour among international investors...

But for custodians, the Latin American market can be treacherous, raising the costs of securities settlements...

In many countries, custodians are hampered by restrictive regulations yet lack a framework of transparency and real time processing...

Yet custody in Latin America is dominated by familiar names. Bank of New York and State Street are among the chief custodians for foreign investors...

In Mexico, there are just five authorised custodians - Indeval, Citibank, Banamex, Bancamer and Inverlat - although Spanish banks BBV and Banco Santander...

There are important differences between the three main markets of the region, Brazil, Argentina and Mexico. Of the three, Argentina is widely perceived as the most receptive to portfolio investors...

Furthermore, Argentina is carrying out sustained efforts to create a clearing house for the market, to facilitate delivery of securities...

In Mexico and Brazil, a series of regulations limit foreign investment to certain share series, making it more difficult to settle customers' trades...

The result of such constraints are limits on liquidity and risky time lags on trades. Rather than just match up orders for the same company when executing trades...

"Though there has been some recent change, Brazil feels that its level of restrictions is important to maintain some control over the economy. Argentina places more emphasis on foreign investment and so is taking steps to make portfolio investment easier..."

"The fact that we now have a centralised system for shares and government and bank securities means that everyone has more information, and transactions can proceed more rapidly..."

The current system has greatly improved liquidity from the old days - a little over two years ago - when just before close of trade messengers used to arrive at the stock exchange building bearing hundreds of cheques...

For that reason, Dr Pérez Galindo hopes that legislation will be approved next year to allow Indeval to become a clearing house taking risk on to itself...

No three words sound sweeter to the ears of a consultant in global custody than Request For Proposal (RFP). Each year there are a handful of custody contracts available, and a limited number of consultancy firms able to assist investment managers in finding the right custodian...

Curt Kohlberg, president of Kohlberg & Associates in Weston, Massachusetts, explains: "If a firm is small and uncomplicated, and if they have a lot of in-house expertise, then they can do it themselves. Usually the medium size to large players use consultancies. It is important that they get it right because there is so much money involved..."

PROFILE Midland Securities Services

Midland is no quitter

As fees for global custody have been shaved in recent years some leading banks have opted out altogether. Among those to quit have been J P Morgan, National Westminster and, most recently, Barclays...

Midland Bank is not among the quitters. Early this year, in partnership with Mellon Bank of the US, Midland won the contract to provide global custody for \$15bn of assets of Prudential Portfolio Management (PPM)...

When HSBC took over Midland in 1992, the UK bank provided custody for just \$40bn of assets. The growth since then is evidence of the group's commitment to this area of its business...

The prima facie problem with Mr McCaughey's theory is that neither NatWest nor Barclays - nor J P Morgan...

also reveals something more fundamental about group philosophy. It shows that HSBC/Midland perceives itself as a commercial bank. Mr McCaughey believes that investment banks, being product-driven, fail to understand the true value of custody services...

Commercial banks, which are relationship-driven, see custody as one way of cementing their relationship with a client. The service then becomes a concrete base for adding other services and thus developing the relationship...

Prudential's attitude to Midland/Mellon as its custodian, seems to bear out Mr McCaughey's theory. Mr McCaughey, director of operations for PPM, will not divulge group strategy prematurely. However, he is willing to say that he hopes the contract will become a platform on which other services may be built...

While growth remains a priority Mr McCaughey now intends to develop a range of added-value products which will lead to the bank becoming an all-round "asset manager". He says quite openly: "MSS won't be a pure custodian for much longer."

gan, for that matter - can be regarded as other than commercial banks. His return is that custody was integrated into the investment banking arms of NatWest and Barclays and that J P Morgan is repositioning itself more as an investment bank...

Midland's main UK competitors, he argues, are Lloyds and Royal Bank of Scotland. All three see custody as a core service. Midland created Midland Securities Services in 1988 to concentrate its custody business which had hitherto been split among several divisions...

Major investment in technology is the key. Prudential's Steve Cook says the Midland/Mellon custody bid beat the competitors because it offered three factors: Midland's deep knowledge of the UK market; Midland's century-long relationship with the Pru; and Mellon's technology...

Already MSS is responsible for the execution-only stockbroking business Midland includes and for similar services on the private banking front. The most compatible products now for adding to custody services are securities lending and collateral management, foreign exchange and treasury functions and repos...



Terry McCaughey intends to develop added-value products

technology. Mr Cook said bluntly: "No". MSS employs around 700 staff of whom perhaps 80 are on temporary contracts related to the introduction of Crest. When the electronic settlement system starts to operate these jobs will go. But Mr McCaughey is confident that his unit will not shrink in numbers...

On the contrary, he is actively recruiting at present - a sign that he believes his development plans are fully backed by the board. Christine Moir

The role of consultants: by David Cowan

Choosing a fast-track route

Consultants can give independent and objective advice, and provide new insights

healy relationship. By buying into a consultancy the investor is tapping into a knowledge base, and a fast-track route to finding a custodian, but at a cost. There are basically three routes the investor can take: do the whole thing yourself; hire a consultant to do it; or use a consultant to handle certain aspects of the RFP, or to review the decision once taken...

The route chosen will depend on the size of operation and the number of markets and instruments under consideration. Curt Kohlberg, president of Kohlberg & Associates in Weston, Massachusetts, explains: "If a firm is small and uncomplicated, and if they have a lot of in-house expertise, then they can do it themselves..."

There are three elements to the selection process. The first is the assessment of risk, second, the technical requirements and, third, the relationship. In selecting a custodian the investor is assuming a number of risks, ranging from custodian risk to which bank to use for local cash clearing, time involved in settling the trade and market risks. The investor should undertake most, if not all, of this research and credit analysis...

The technical and relationship assessment is where the consultant can really add value, based on work with other clients. These are the methodical tasks associated with data collection, both the automated and manual varieties, systems linkage, and reporting processes. The investor still needs to know roughly where to look to get the best support, and

payments systems, time-gap, cross-border delays, foreign exchange. The investor then needs to issue an RFP, which will cover these essential areas: a description of the organisation, a profile of the investment programme, a definition of the key terms used, basic information relating to custodian issues, the basic requirements of the custodian to be selected, description of services and functionality to be provided by the custodian, description of reporting, balancing and reconciliation between the investor and custodian, custodian audit and regulation information, custodian insurance coverage, custody fees, a draft custody agreement. Having prepared the way it is time to call in the consultants, which itself involves a selection process, but at least you know what to expect. At this stage it is very much the old cliché of handing over the watch so the consultant can tell you the time.

Derivatives: by Samer Iskandar

Valuation a competitive tool

Financial institutions are turning to custodians for pricing derivatives

Nothing should worry financial risk managers more than a list of securities - or worse, derivatives - priced at their par value. More often than not, this means that no-one was able to find an accurate price for the security. Although problems in the valuation of traditional financial instruments - such as shares and bonds - are becoming less frequent, this has not been the case for derivatives. As increasingly exotic products are traded, the sources of information on their pricing become less easily accessible or, in some extreme cases, non-existent...

As a last resort, back-office employees sometimes have no choice but to ask traders in the dealing room, or even the issuer of the product, for an indicative price - "not necessarily the most objective sources", one financial consultant commented. Banks and financial institutions, therefore, are turning to global custodians - their traditional suppliers of market prices - for these services. And the custodians, although more familiar with the pricing of conventional securities, seem willing to rise to the challenge.

Observers say diversification into derivatives is a boon to custodians, which operate in a cutthroat environment where traditionally thin margins are shrinking further. "The biggest issue facing custodians is the valuation of derivatives", said Andrew Lese, vice-president of Emcor, a US risk management advisory firm. Ron Dembo, president of Algorithmics, a provider of financial risk management software, concurs. He also underlines the importance of risk management as a marketing tool. "In addition to the usual marketing tools - offering more services at

lower prices - risk management allows [custodians] to differentiate their product." Cedel Bank, the Luxembourg-based clearing bank, is pioneering this approach. Last month it launched an innovative product, Global Credit Support Service (GCSS), a real-time system for the management of collateral on over-the-counter derivatives trades, notably currency and interest rate swaps. The philosophy behind the system is not new. It is directly inspired by the operations of the clearing houses of derivatives exchanges. However, Cedel insists GCSS "is not a clearing service, but a credit support system". Depending on several variables including the credit standing of counterparties, the level of market prices and volatility - the system constantly calculates the adequate level of collateral required to maintain an existing transaction throughout its life, several years in some cases.

But although GCSS is a welcome addition to risk management techniques in the derivatives marketplace, analysts believe the gap between the market's evolution and risk management systems is still widening. "The market evolves so quickly that keeping up with it is like running behind a train," said Heinz Ringgell, president of US-based Global Investment Risk Advisors. Among GCSS's shortcomings is the fact that it handles trades on a bilateral basis. Each bank has to manage collateral on every trade entered into the system, with little allowance for netting - or offsetting trades that cancel each other's risk exposure. As a result, immobilised collateral is often larger than necessary.

GCSS does allow for some netting: when two institutions have several outstanding trades with each other, it will calculate collateral requirements on the net exposure. But since the system operates on a client

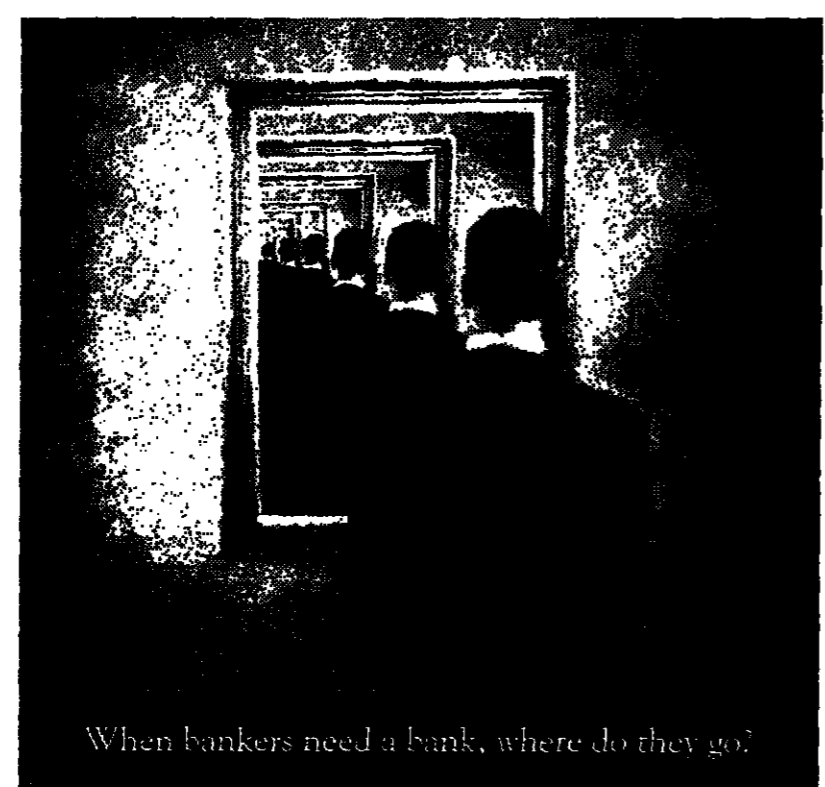
basis - as opposed to a product basis - it provides no netting arrangement between mutually-offsetting trades that one institution might have with different counterparties. Good quality custodial services seem to hinge on a combination of efficient netting procedures and accurate pricing techniques. The absence of netting not only leads to inflated collateral requirements from clients, it also strongly affects the cost structure of the custodians, because they need to immobilise a proportion of their own capital as a buffer against potential default by their clients. Since, in a large community of clients, there always exist positions that offset each other's market risk, the net aggregate exposure of positions managed by a custodian is often significantly lower than the sum of the different exposures. Therefore, an enhanced ability to detect these trades would remove the need to immobilise capital against them, since gains on some clients' portfolios would offset the losses on others.

In addition to netting, accurate pricing of derivatives is also an important consideration for custodians. Because they determine the

amount of its own capital a custodian needs to immobilise, pricing methods have a direct effect on profitability. On the one hand, unreliable pricing could lead to an increase in the default rate, if the custodian's estimate of adequate collateral is too low. On the other hand, overstating risk would lead to overpricing custodial services.

Mr Dembo at Algorithmics believes that "estimating the most appropriate level of capital is the key to providing the best pricing". He warns, however, that "this is a difficult scientific exercise". One important impediment to both netting and accurate pricing of complex instruments is the lack of understanding of clients' ultimate aims. One observer points out that if the custodian trade was purely a hedge against a cash position in the underlying market, it could, in theory, require less collateral than on an identical trade set up for purely speculative reasons.

Mr Dembo is convinced that in many cases, "if custodians knew the risk profile of their clients better, they would be able to price their services more competitively".



When bankers need a bank, where do they go?

GENERAL CUSTODY Lazard Brothers Asset Management June 1996 Assets under custody US\$600,000,000 A Bankers Trust

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Management of sub-custodians by Margaret Morris

The art of buying peace of mind

Setting up a network requires crucial decisions by custodians and also by clients

When an investment business buys global custody, it is buying peace of mind – and that means no more sleepless nights over failed trades in Swaziland. Ideally, says Alison Clare, head of product management and marketing for Royal Bank of Scotland, "the global custodian has to be able to shelter the customer".

But given the number of markets – up to 75 in some cases – and the immature infrastructure within some of the emerging markets, the global custodian cannot take financial and legal responsibility for all events that occur after a trade instruction reaches its doors.

For global custodians, how to set up a sub-custodial network, which banks to choose as agents, and when to expand the network are crucial decisions. But clients are just as interested in these matters. A smoothly functioning sub-custodial network means that losses from failed trades or missed corporate actions just do not happen. Keeping those wheels greased requires a big effort. The biggest source of friction between client and sub-custodian remains how to deal with exceptional situations.

There are two routes to follow in setting up a sub-



Alison Clare: the custodian has to shelter the customer

custodian network. One is to use its own branches or subsidiaries to perform custody within local markets. This strategy, pursued to varying degrees by Citibank and Chase Manhattan Bank, requires a historical presence in most of those countries. A bank does not arrive to set up a sub-custodian; it usually had other domestic banking business there already. For Citibank in particular, providing sub-custody of a speciality, such as an extent that in areas like Latin America, many other global custodians use their network for sub-custody. The bank's rising credit rating has helped it win customers that would rather deal with a well-capitalised international bank than a

thinly capitalised local operator, however efficient.

The other route, followed by more global custodians for fairly obvious reasons, is simply to choose the best agent bank within each market. This is a complex and ongoing process, with yearly visits and constant monitoring and evaluation procedures. "Every custodian is prepared to switch agents quickly within a market; there is always a back-up agent in place," says Paul Burgess, manager of the sub-custodial network for Lloyds Bank. And some large custodians will use more than one agent in a country simply because one bank could not handle the volume. In some major markets, says Mr Burgess, more than one sub-custodian is used. He cites the US, Germany and Japan as markets where Lloyds has more than one agent.

Even for a bank with access to a relatively large sub-custodial network, as Midland has with its associated bank, Hong Kong Bank in Asia, the best in class argument holds. Says Steve Croxford of Midland Securities Services: "We look at Hong Kong Bank just as we would any other agent. We get no preferential treatment because we are part of HSBC Holdings and we expect none. They have to meet our standards and be the best provider in the country."

The ability to switch sub-custodians is the most often cited as the rationale behind using an agent network. But James Economides, managing director, global custody at Citibank, explains that

the proprietary network brings other deeper advantages. "When you use your own branches, you are assured that the quality standards are the same across the network and that the technology used is the same. And while that may not be any more advantageous than using SWIFT messages for trade instructions, it is very helpful when it comes to receiving corporate action information," says Mr Economides. Although Citibank offers custody in 57 countries, only 45 are Citibank branches, but, says Mr Economides, "98 per cent of the volume is through Citibank."

Another way to organise a sub-custodial network is to use regional custodians. Citibank has recently organised three regional hubs in Asia, Europe and the Americas to streamline service.

But even for those banks that use agent banks, some custodians such as Standard Chartered Equitor in Asia and Citibank in Latin America offer a regional service, with one legal contract for 10 to 14 markets and consolidated corporate actions feeds.

Global custodians have been competing in recent years for the contractual services they offer customers. From the ubiquitous contractual settlement to the controversial contractual corporate actions, these services ostensibly protect the customer from any problems encountered within the sub-custody market. "It is very important that customers understand exactly what is

PROFILE Morgan Stanley

A banking enigma

Among the world's leading institutions in global custody, Morgan Stanley remains an enigma. Unlike almost all of its competitors, Morgan Stanley is an investment bank, not a commercial or trust bank. Thus, the move to custody of client assets was not a natural progression into a new business as it was for, say, Chase or even Brown Brothers Harriman.

Moreover, its push into custody came in the late 1980s making it a relative newcomer to the business. Even now, its global custody assets are only a tenth of those of Chase, the industry leader.

Yet, Morgan Stanley says its custody operations are enormously profitable and return on capital for custody and related services at least equals that of other bank activities. And Morgan Stanley is understood to be in talks to acquire the global custody operations of Barclays Bank, although its top officials demur when the question is put to them.

Why Morgan Stanley has chosen to be in a business which has been shunned by other investment banks, and how it has managed to make money where others have failed remain open questions. Goldman Sachs, for instance, a close competitor of Morgan Stanley in many other businesses, made a public effort to enter the custody business and then quickly faded away.

The origins of the investment bank's business are in the Trade Automated Processing System (Tape) which it developed in the mid-1980s as a broker-dealer support system. It was a kind of customised custody-cum-record-keeping system which, critically, had a multi-currency capability.

"We realised that capability could be translated to a custody business," says David Newman, head of European global custody. The system emerged just before US institutional

investors began to diversify their portfolios into non-domestic securities, first bonds and later equities.

Morgan Stanley's strategy, Mr Newman says, has been to build a "seamless continuum" from the purchase of a stock, clearing and settlement of the transaction, recording the valuation of the security, using it as collateral for loans or the outright loan of the stock itself to the eventual sale of the security and the banking or re-investment of the proceeds.

The secret of the operations profitability, consultants say, is that Morgan Stanley has been able to figure out how to take a fee from every stage of a securities transaction, and preferably from both parties to that transaction.

The custody business has also bolstered Morgan Stanley's prime brokerage business, which has come of age with the emergence of a hedge fund industry on both sides of the Atlantic. Prime brokerage effectively means providing a back office/financing arm for hedge funds or other investors who use their existing portfolios to leverage future investments.

Morgan Stanley has also used its own fund management division to bolster the profitability of its custody business.

Securities in its own portfolio can be loaned to custody clients, earning a turn for both sides out of which the investment bank takes a cut as well, consultants say.

"They have always been very good at technology," says Richard Schwartz, partner at consultants Lee Schwartz Associates.

Morgan Stanley officials privately acknowledge that its ability to provide a service at every juncture has made its custody operations profitable, while larger competitors have fallen by the wayside. However, the bank believes custody could be more profitable still.

Morgan Stanley has eschewed the strategy of competitors such as Bank of New York which view global custody as a "commodity" service that can only be profitable when offered on a very large scale. Instead, it has concentrated its sales on those to whom it can sell lots of services.

It has pledged "upwards of \$100m" for upgrading technology in the next few years.

At the heart of Morgan Stanley's push into global custody lies the expectation that equity investment worldwide – and in Europe in particular – is about to boom.

Morgan Stanley is convinced that there will be much more demand for "passive" investments – investments in stocks which mimic key indices such as the FTSE 100. These portfolios are particularly attractive for custodians because of the potential they offer to build stock lending fee income.

But there is another goal. Global custody is a business that does not require a large balance sheet and which can provide stable income when securities markets are volatile. Morgan Stanley is anxious to divorce its share performance from those of some of its peers with more volatile earnings. Building a core business with stable earnings is aimed at addressing that issue.

But why then, should Morgan Stanley wish to acquire Barclays?

Morgan Stanley officials refuse to be drawn on the talks. However, consultants note that custody of the Barclays Global Investors passive portfolios – the world's largest – would be a feather in the bank's cap. Also, it would give the bank a presence in the key UK pension fund market where it now has a limited share.

Norma Cohen

Corporate governance by William Lewis

Investors get tough

US investors are the main drivers of the new activism in Europe

These are exciting times for those involved in the growing corporate governance market in Europe. Several high profile clashes in recent months between companies and shareholders have led to speculation that European markets are catching up with the highly developed corporate governance industry in the US.

In Italy, Olivetti, the Italian technology group, has come under pressure from London-based institutional investors, following the controversial replacement of its chief executive. In France, small shareholders in Euro-tunnel may yet reject the financial restructuring put together by the company's management and main bankers.

And in the UK, the most developed corporate governance market in Europe, there have been several examples of institutional investors taking a tough line with underperforming companies and also companies at which executives' bonus plans are inappropriately structured.

"Corporate governance has become an integral part of City life," says Anne Simpson, joint managing director of Pirce, a London-based corporate governance consultancy.

Sir Stanley Kalms, chairman of Dixons, the electrical retailer, is a critic of bureaucratic procedures and says that while corporate governance is an industry, it is "running out of control".

If the trend continues, and European institutional investors develop their corporate governance activism in the same way as US investors, institutional shareholder clients are likely to become increasingly keen on

global custodians exercising their proxies at company meetings.

Some custodians see corporate actions and proxy voting as part of the package of services which a sub-custodian takes on when a contract is negotiated. However, other custodians who do not offer the same package are worried that clients will begin demanding free voting.

"Different custodians are taking different approaches," says Corinna Arnold, director of global shareholder service at the Investor Responsibility Research Center in Washington, DC. "They are not very thrilled about it, but it is part and parcel of the job".

One of the main drivers of the new activism in Europe has been US investors holding shares in European companies. Since 1988 the US Department of Labour has interpreted the ERISA laws, which set out the rules under which US pension schemes are administered, to mean that there is an obligation to scheme members to exercise their rights at companies at which they have a stake.

As a result custodians say that US pension funds vote almost all the time and on every issue laid before shareholders by US corporations.

In July 1994 the US Department of Labor clarified the obligations of some US pension funds to exercise their votes abroad in the same way as they do in the US.

Investors based in the US have also been playing active roles in shareholder revolts at companies based in the UK and elsewhere in Europe.

For example, US investors

initiated the process which led to Maurice Saatchi and Charles Saatchi, founders of Saatchi & Saatchi, leaving the advertising agency. The California Public Employees' Retirement System, Calpers, the largest public pension fund in the US which is known for its corporate governance activism, has announced its intention to become more active in the UK and in other European markets.

With this increasing pressure from US investors, UK investors are becoming more active. Twelve months ago the National Association of Pension Funds, whose members have £300bn under management, told their institutional shareholders they have a duty to vote at companies' annual meetings to ensure they are acting as responsible investors.

A poll of fund managers found that only 28 per cent voted regularly, against 32 per cent who voted only on contentious issues and 21 per cent who never voted.

With the Labour party promising to introduce legislation to force funds to vote, the NAFF also warned that unless pension funds begin voting regularly they could be forced to do so.

European investors have argued that voting is too expensive and too time consuming, but Ms Arnold says that custodians, having come under pressure to provide global proxy voting services for their US ERISA accounts, have "developed systems that now allow them to offer these services to all of their clients – and most certainly to those clients who demand it."

"This has meant that those investors who wish to receive global proxy ballots and to cast their votes can now do so, and growing numbers are taking advantage of that fact," she says.

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Rank	Bank	Worldwide custody assets Total (\$m)	% of total custody assets
1	Chase Manhattan	1,006,000	30.3
2	Citibank	567,000	50.5
3	Bank of New York	484,000	15.9
4	Deutsche Bank	457,000	68.3
5	State Street	369,900	15.1
6	Bankers Trust	366,000	24.6
7	Bank of Tokyo Mitsubishi	291,384	97.9
8	Brown Brothers Harriman	250,000	78.4
9	Barclays Bank	167,225	58.8
10	ABN Amro Bank	162,000	55.7
11	Royal Trust Corp of Canada	117,673	40.9
12	Morgan Stanley Global Custody	102,000	80.3
13	Société Générale	100,000	41.7
14	Northern Trust	82,800	14.5
15	Midland Securities Services	68,615	22.7

Source: Institutional Investor, September 1996

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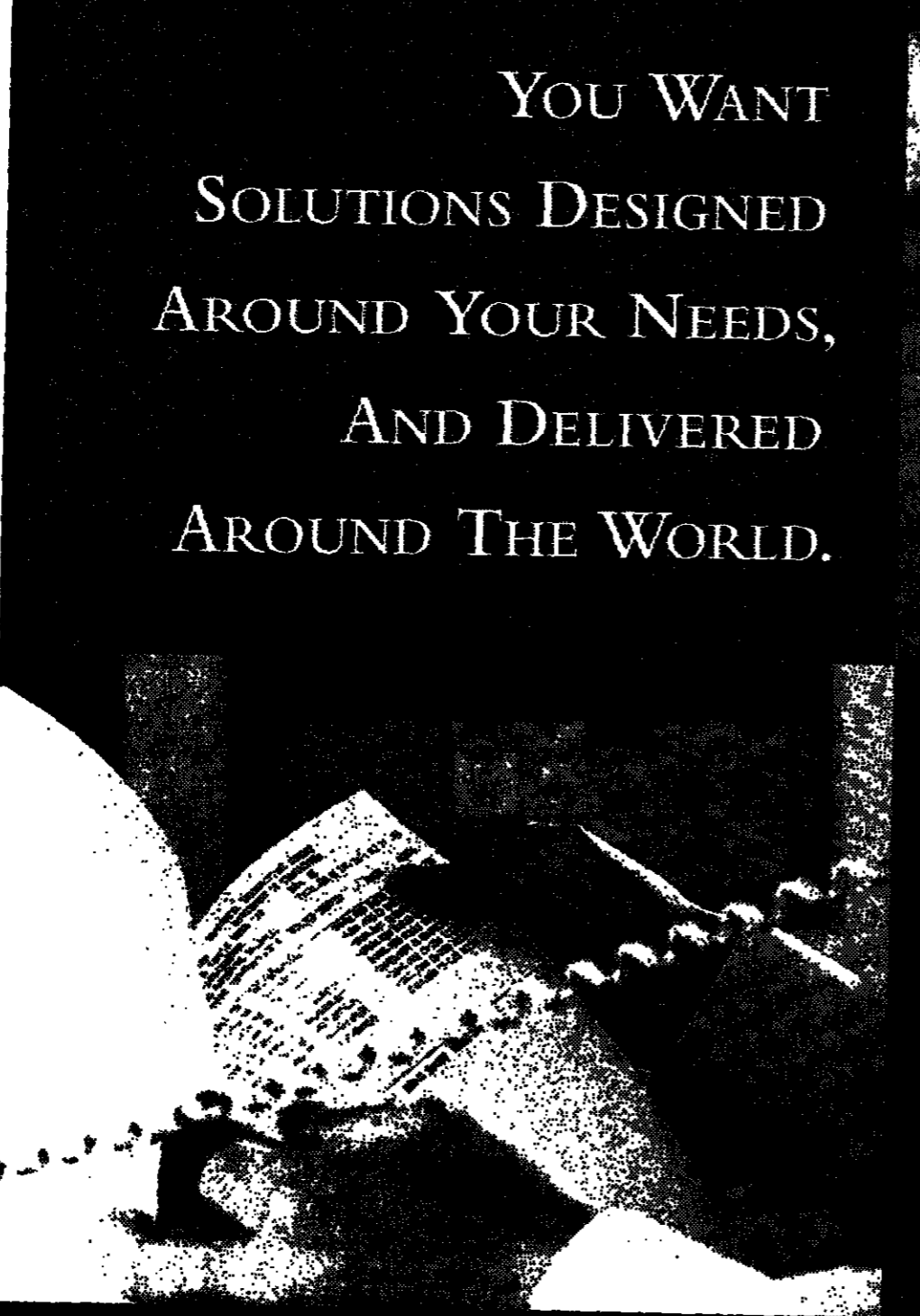
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